HAAGA-HELIA
University of Applied Sciences

Designing guidelines to monitor and measure the impacts of ethical banks' operations

Hans Goebel, Linh Tran

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Abstract

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Authors Hans Goebel & Linh Tran	**Group or year of entry** 2014
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During recent years, ethical banks established themselves as alternatives to commercial banking. While many major banks struggle since the 2008 financial crisis, many ethical banks count one record year after the other. Ethical banks attract customers not by high interest rates but thoughtful investment in social, environmental and sustainable businesses and projects.

This Bachelor's thesis deals with measurements and monitoring ethical banks do to ensure that the projects they support by lending money are really done in an ethical, sustainable way.

The overall purpose of this study is to develop guidelines ethical banks can use to assess and monitor the projects & businesses they invest in. The objective was also to analyse the impact measurement and monitoring practices selected ethical banks use at the moment.

This thesis consists of a theory part, an empirical part and discussions. Over the period of 5 months, data was collected through qualitative research. The theory is drawn together from academic publications. For the empirical part secondary data from books & the banks' reports were used. Additionally, the authors collected interviews with banking officials to verify the secondary data.

Keywords
Ethical banking, sustainable development, transparency, risk management, triple bottom line, monitoring

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1 Introduction

The financial crisis of 2008 revealed a lot of controversial activities of companies in the financial sector. Many were shocked by the obvious lack of social commitment especially of the big financial institutions and banks around the world. Numerous banking practices were put under question. The pure striving for profits seemed to be a major contributor to the worldwide financial instability and many people started to look for an alternative. One of such alternative is ethical banking. While major banks struggled during the last years, many ethical banks counted one record year after the other. The developers of ethical banking saw potential were other only saw costs: social commitment, environmental responsibility, transparency & sustainability are their key words. Instead of aiming for a high bottom line only, ethical bank look for more. They target to be the connection between lenders, who want to make an ethical difference with their money, and borrowers who have an idea for a social and/or environmental project and need funding. To support progressive projects and companies in the best way, ethical banks provide cheap financing and loans with small interest rates. On the other hand, compared to commercial banks, they can only provide very low rates of return to their own customers. Instead, they offer something different: the feeling to make a change.

What sounds so sophisticated actually proves to work. Brazil based ABN AMRO REAL's corporate portfolio increased by 32% in 2007 after adopting ethical banking principles two years earlier (Spitzeck, Pirson & Dierksmeier 2012, 28). Italy's Banca Etica provided almost 2 billion euro as loans and increased their direct deposits by 11% in 2013 alone while the average for Italian banks was -2% (Il Gazzettino Padova 2014). The Dutch Triodos Bank grew constantly in almost every aspect over the last 20 years. With net profit rates of over 10% over the last decade and 25.7% in 2013 they established themselves as a key player on the international banking market. (Spitzeck et al. 2012, 161; Triodos Bank 2014a.) Records are also reoccurring events for the German GLS Bank, which noted total asset growth of 27% in 2008 and 37% in 2010 (Spitzeck et al.2012, 107). With these numbers in its back, ethical banking could become a real challenger for commercial banks in the near future.

1.1 Objective of research

The main objective of this thesis is to develop guidelines ethical banks can use to asses and monitor the projects they invest in. Ethical banks set themselves social and environmental standards which projects they support financially have to fulfil. When an ethical bank signs a loan agreement with a business partner, ethical terms are agreed to which the partner has to stick. To ensure this, it is necessary for the bank to do 2 crucial enquiries. First, it has to assess if the outcome of the project fulfils the stated ethical norms. Second, especially for projects with a long runtime, it needs to be monitored if the ethical standards are met while the project is running. To accomplish this efficiently, this report will set up guidelines an ethical bank can use.

This main goal is achieved by researching the background and development of ethical banks. Furthermore, the research covers the current practices ethical banks use to assess the impacts of the projects they invest in, as well as the monitoring processes they have to ensure their business partners follow the ethical practices they promised when agreeing to the investment plan. Additionally, it is the objective of this thesis to line out the pros and cons of the developed guidelines in order to specify for which ethical banks the guidelines would be helpful.

The guidelines the authors develop are aimed to assist people who plan to create a new ethical bank. The guidelines are not shaped for the purpose of our research partners (which we introduce in chapter 1.4). These ethical banks are well established and have own methods to ensure working monitoring and measuring processes. However, newly founded banks do not have their expertise and might struggle in how to deal with projects and project owners they want to support. Therefore, we create new guidelines as an orientation. This study will point out what tasks are important and need to be prioritised by new ethical banks, as well as tasks which are secondary and do not need many resources to deal with. In this way the authors hope to contribute a small amount to the development of ethical banking.

To clarify the process needed to achieve the objectives of this thesis, the authors formulated a research problem and investigative questions. These are subject of the next chapter.

1.2 Research problem and investigative questions

This study is research based and is within the specialism of international finance. At its heart is the following research problem:

Designing guidelines to monitor and measure the impacts of ethical banks' operations.

To attend this problem it, the authors divided the banks' side of the process to assess borrowers into 3 steps. These steps do not represent how the research partners of this thesis are internally organised, nor do they necessarily use these names for their steps. However, to ensure a useful study the researchers deemed these steps as helpful, logical & necessary. The steps are lined out in Figure 1.

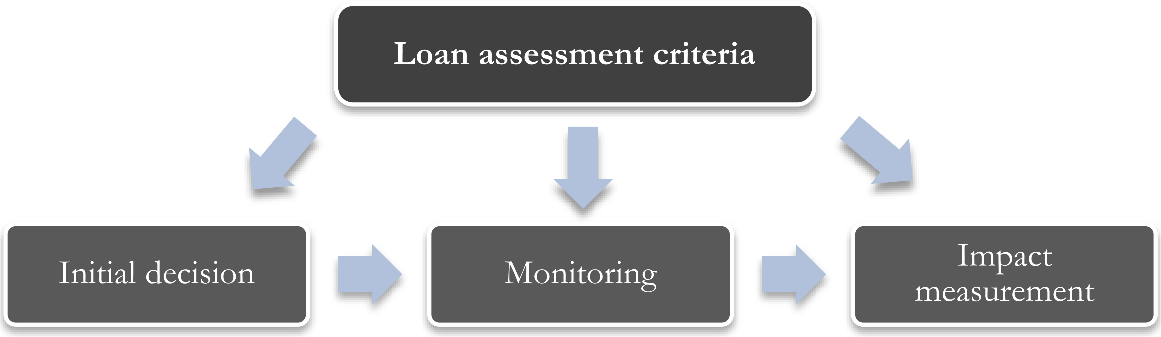

Figure 1. Borrower assessment process.

On top of the process are the assessment criteria an ethical bank is using to define which borrowers are eligible for a loan and which ones are not. The criteria influence all three steps of the process. Loan assessment criteria of banks may include financial, social and environmental issues. There may be positive criteria, which borrowers have to fulfil in order to obtain and maintain financing. There may be negative criteria, meaning that borrowers should not meet them in order to receive financing, too.

The first step of the process is the initial decision for or against lending to a borrower. With the help of the loan assessment criteria a bank will decide if it provides loans or other means of financing to a company. The initial decision stage can be considered as the preliminary process of a larger impact measurement process. It is the process in which banks perform screening on a variety of investment opportunities and pick ones that align with their purposes to bring about positive social changes and acceptable financial return. Without a good implementation of the initial decision, the banks will not only have difficulties in assessing the impact of the projects later on, but also the outcomes of such projects can deviate from the ethical path of the banks. In this thesis, the authors will not discuss this stage in details as it is outside the scope of the project, but it is necessary to state that this step plays a crucial role in the impact measurement process.

The second step consists of monitoring the borrower. After a loan agreement is reached a bank wants to monitor the development of the project they invested in. This is important to answer questions like, 'can the loan agreement be met?' or 'is further financing necessary?' and 'does the project fulfil its ethical targets?'. This step is a focus point of this study and the researchers set up investigative questions addressing different parts of the monitoring, which are mentioned below.

The third step focusses on what an ethical bank does to measure what environmental, social and financial impact a loan had. As such it is closely connected to the other steps, which are mentioned above. It aims to identify how successful the cooperation between the bank and the project was and if decision and monitoring processes have worked. The initial decision process is especially important for the impact measurement. In this first step, the bank may lay out targets the project should meet. In the impact measurement process, the bank will then analyse if the project met these targets, or if it exceeded or fell below them. For an ethical bank this mostly aims towards ethical, meaning social and environmental goals. However, it includes also financial goals which were set up. Possible financial endings, which are interesting for an impact analysis, could be that the loan plan is fulfilled, or it got terminated (for instance because the company went bankrupt). The end of the loan agreement is not automatically connected to the end of the relation between borrower and lender. Further financing might be requested or the borrower might start another project which needs financing. The key issue of the impact measurement step is to reflect on the outcome of the loan. It cares if both partners are satisfied with the end result. 'Were ethical criteria kept by the borrower?' 'Were payment dates and amount followed?' And most interestingly, 'what is the impact of this fulfilled operation?'.

The authors broke down the process into investigative questions, which can be found in table 1. These questions focus on the second and third step of the loan assessment process. The aiming is to research how the research partners handle these challenges in-house, and with the help of these results to prepare and assess guidelines for new ethical banks.

Table 1. Investigative questions.

Process	**Investigative question (IQ)**
Monitoring	1. What methods do banks use to monitor their supported projects? 2. What are the advantages and disadvantages of these methods? 3. How to design guidelines to monitor supported projects and companies of ethical banks'? 4. What are pros and cons of these monitoring guidelines?

Impact measurement	5. What methods do ethical banks use to measure and analyse the impacts of their activities? 6. What are the advantages and drawbacks of such measurement methods? 7. How to develop guidelines to assess the impacts created by the ethical bank's activities?

To address these investigative questions, a combination of secondary and primary research is necessary. The authors start by researching the background of ethical banking and its major players. The primary focus is on the research of the GLS bank, with the Triodos bank as second focus. A third bank, the British Charity bank, aids as a comparison tool. The banks are introduced in chapter 4.

To find out more about the impact measurement and monitoring practices of ethical banking, secondary research are used in form of web sources, books and publications. Additionally, there are interviews with banking officials as a source of primary research.

1.3 Authors' contribution

This research is a pair thesis and is done by both authors on equal terms. To enable fair assessment the authors agreed to share the workload as follows. Both partners are in the same degree programme and chose the same field of specialisation.

To gain an appropriate insight into the topic, this introductory chapter is written by both authors in cooperation. The second chapter, about theory and background is written by both authors in cooperation, too. The theory of ethical banking is the foundation of this thesis, and by collaborating it is ensured that both authors are prepared in equal manners.

The individual parts are along the empirical part (chapter 3) and in regard to the investigative questions. Investigative questions (IQ) 1, 2 are addressed by both authors but for different banks. Therefore, these are considered individual parts. Both partners do these investigative questions fully separate for their assigned banks. That includes secondary research as well as interview requests, interview handling and others. Linh Tran researches these IQs for the Dutch Triodos Bank, while as Hans Goebel focuses on a more in depth research on the German GLS Bank. As the prime focus is on GLS bank, the authors agreed that Linh Tran handles these IQs for the third bank, Charity bank, as well.

The focus point of the thesis are the third and seventh investigative questions, and therefore both authors handle these tasks together. The guidelines to assess the impact of operations are designed collectively. Investigative questions 5 & 6 are done individually again. Linh Tran assesses the guidelines for pros and cons and hence, focusses on them. Hans Goebel on the other hand deals more closely with the IQs for monitoring systems. To simplify the assessment every main chapter states by which author the work is done. A comprehensive version of the contribution plan can be seen in table 2 below.

Table 2. Authors' contribution.

IQ	Responsibility	Note
1	Linh Tran, Hans Goebel	IQ 1 is done by both partners. However, it is individual work as both focus on different banks. Linh Tran: Triodos Bank Hans Goebel: GLS Bank Linh Tran: Charity Bank
2	Linh Tran, Hans Goebel	IQ 2 is done by both partners. However, it is individual work as both focus on different banks. Linh Tran: Triodos Bank Hans Goebel: GLS Bank Linh Tran: Charity Bank
3	Linh Tran, Hans Goebel	IQ 3 is the heart of the thesis and is done by both authors together.

4	Hans Goebel	Hans Goebel expands on the pros and cons of monitoring systems an ethical bank can use.
5+6	Linh Tran	Linh Tran handles these impact measurement related investigative questions.
7	Linh Tran	IQ 3 is the heart of the thesis and is done by both authors together.

1.4 Key concepts

The research is built upon concepts of ethical banking, sustainability, transparency and risk management. Among others, these are introduced in this chapter.

Ethical banking is an umbrella term for a banking model that encompasses all the banks that "have ethical and sustainable development elements at the core of their mission, ambitions and practices" (de Clerck 2009, 209). An ethical bank can also be called a "social bank". Some experts might argue about this difference in the semantics of these two terms (Paulet & Relano 2012, 149). However, in this paper, we determine the two terms synonymous and use them interchangeably. That being said, there is no strict definition for what is an ethical bank. An ethical bank can be of different types. It can be an alternative bank, a cooperative bank or a universal bank. However, they share a certain set of common characteristics which are demonstrated through their policies and operations that set them apart from a conventional bank. We will discuss about characteristics that define an ethical bank later on.

One of the key issues of ethical banking is **sustainable development**. The most common definition of sustainable development was made by the World Commission on Environment and Development, which says that "sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (1987, 41). It reflects the idea of our planet as a closed limited system in which influences such as pollution in one place will affect our whole world sooner or later.

Transparency is a very broad term which the WTO defines as "degree to which trade policies and practices, and the process by which they are established, are open and predictable" (2014, in Forssbaeck & Oxelheim 2014, 6). In the cases of banks that does not only apply to their investment strategies but to the activities of their borrowers, too.

Risk management refers to all activities, policies and methods companies use to measure, monitor and control risks regarding their business (Bessis 2002, 1). Banks are exposed to various kinds of risks, like credit risk, exchange rate risk and others. However, for this research we are only looking for risk management ethical banks establish to address the risk of misuse of money by the borrower. Ethical banks have a social responsibility over the projects they support. The question if money they lend gets really used in the way it was promised by the borrower is a risk for an ethical bank. Therefore, it needs to establish a system to manage this risk.

Instead of looking only at one bottom line, the profit, companies may prepare a **Triple bottom line (TBL)**. The concept of TBL says that companies should prepare 3 individual results. Besides the yearly profit, there should be two more measures called 'people' and 'planet'. The people bottom line stands for the social responsibility the company had, while as planet counts the environmental impact. (The Economist 2009.) In general TBL states that social and environmental aspects should be reported by companies the same way financial statements are (Norman & MacDonald 2003, 1).

Monitoring the proper functionality of business processes is an important task for any bank. However, ethical banks have some additional need for monitoring. Monitoring itself is defined in the Oxford dictionary as the action to "observe and check the progress or quality of (something) over a period of time" (Oxford Dictionary). For ethical banks, that includes the supervision of the projects they invest in. Any ethical bank needs to make sure that the lent money is used in the intended way and is not misused by their business partner. Over its whole runtime the project has to meet the ethical criteria which the bank set up at the time of lending. To ensure this, monitoring may be necessary.

2 Ethical banking as an alternative banking model

This chapter explores development ethical banking and how it has become a desirable alternative banking model in the last decade, especially after the U.S. subprime mortgage crisis in 2008 and the European financial crisis. The following content will cover all the basic information about ethical banking, from its conception in the early 70s, development throughout the history to the main characteristics of the model and challenges the sector has to face in order to grow and compete with conventional banking sector.

2.1 Origin, history & development

Ethical banking refers to a banking system in which the banks focus on making social and environmental impacts and promoting sustainability and transparency through their practices. The following section will discuss about the origin and development of ethical banking from its early inception to its current state.

2.1.1 Early history of ethical banking

The first ethical banks were founded in the 1970s but its roots could be traced back as far as the birth of the banking system. Some of the earliest banks in the world was created in Italy in the 15th century and were considered community banks. They acted as intermediaries between the lenders and the borrowers, ensuring a financial stream available from the ones who could provide capital to the ones who were in need of capital to run businesses. Unlike the profit-driven modern banks, these early banks aimed at supporting local community economies by providing funds to small and medium businesses and making loans to the poor. It is shown that the main policies of some of these early banks were the original template for the CSR guidelines that financial organizations use nowadays. For example, one of the oldest forms of banking was called 'monte di pietà', which was operated as a charity and a means to provide people of less privilege with access to cheap credits. Some of their core lending strategies are presented as follow:

- Prioritize borrowers from the local community
- Providing loans to local bodies when crises occurred.
- Aim at lending to more and more women,
- Take part in social activities in the local community.
- Lend to borrowers with high creditworthiness.
- Encourage the use of mortgages. (Milano 2011, in Weber 2013, 5.)

These strategies share many similarities with the terms from the corporate social responsibility (CSR) statements of a modern bank nowadays. As seen above, the monte de pieta were founded on ethical purposes and were seen as an alternative to the loan sharks and interest-conscious private money lenders of that time. "Monte" means "heap" or "pile", signifying the collection of funds the bank accumulated from the donations made by the financially privileged class. (Milano 2011, in Weber 2013, 5.) Characterized by its links to the Catholic churches, the monte di pieta would encourage people to donate money as "gifts or donations in honour of a person's love for God" to help the poor and strengthen the local businesses (Menning 1992, 667).

In short, ethical banking as a practice existed as far back as when the first banks were created. However, ethical banking as an independent concept only came with the birth of financial cooperatives during the 18th century.

2.1.2 Development of modern ethical banking

Ethical banking as a separate concept began to differentiate itself from conventional banking since 1970s when credit unions and cooperative banks emerged. These organizations wanted to re-incorporate social values into financial industry with a view to creating a more sustainable and social-oriented banking model. The reason credit unions and cooperative banks are mentioned in relation to ethical banks is because they laid the foundation for the social and sustainability standards which would be later used and improved on by ethical banks. During this period, the first ethical banks were founded. Among them are Co-operative Bank (UK) in 1971, Shorebank (US) in 1973 and GLS (Germany) in 1974. Their banking approach was a bit similar to the financial cooperatives in several principles: supporting community relations, giving loans to local businesses and democratic decision making. On the other hand, ethical banks added new ethical perspective into their operations, such as avoiding financing dictatorial regimes and being more active in areas where environmental issues were concerned. The main factors contributed to this shift were the introduction of new environmental regulations, the increasing energy price and waste management price and investor's growing awareness of social and environmental responsibility. (Weber 2013, 5.)

As the blooming phase of credit unions and cooperatives banks in the early 70s was over, financial industry was heavily influenced by the wave of globalization as the multinational banks began to control the market, prioritizing on making profit for the organizations instead of focusing on the benefit of the community as a whole. The big banks created more innovative financial products and services which often contained more risks but yielded larger profit margin. The financial industry continued to experience growth and some banks were elevated to the Too Big To Fail status. At the same time, these banks received criticism for enriching themselves through clever financially-engineered products but continued to distance the growth of the financial sector from the growth of real economy. (Bank of International Settlement 2014, 3.) In the meanwhile, ethical banking remained as a niche market.

The bubble was burst with its first warning sign from the collapse of Lehman Brothers (one of the US investment bank giants), and the merging of Merill Lynch into Bank of America during the US subprime mortgage crisis in 2008. The following European financial crisis, which is on-going since 2009, once more put the weaknesses of the current banking system in the spotlight as many banks collapsed or went into liquidation while the ECB had to issue bailout programs to save struggling banks. The global financial crisis, on the other hand, helps ethical banking to gain momentum and attention from some critics who view the model as an answer to the financial crisis. (Benedikter 2011.) As the social banking sector thrives and grows consistently during the crisis, a new movement arises with an aim to unify the banks of common goals. Global Alliance for Banking on Values (GABV) was founded by 12 social banks in 2009 and is considered a general platform for communication and advocacy of the social banking movement. Nowadays, the organization has increased the number of its membership to 25 banks and financial institutions with combined assets of around $100 billion. (Global Alliance for Banking on Values 2013a.)

2.2 Characteristics of ethical banking

In this chapter it will be discussed what makes ethical banks special from normal banks. After all, most commercial banks nowadays have a code of conduct and other internal ethical norms and standards they follow. To understand why ethical banks exist; it is necessary to focus on its characteristics and compare them to the ethical behaviour of commercial banks.

Ethical banks have social and environmental targets as their core. This is expressed in a concept called triple bottom line (TBL). As described in chapter 1.5, the triple bottom line principle says that a company (in this case bank) should prepare three individual annual reports. The idea is that a company regards social and environmental influences equally important as their financial results. Ethical goals should not accompany financial targets but are on the same level. For an ethical bank, that means that signing a loan contract to increase the financial position is only beneficial if it affects the social balance in a positive way, too. Any improvement of the financial situation at the expense of the 'planet' and 'people' balances needs to be avoided.

To react to the challenges the TBL brings at hand, banks use strategies such as socially responsible investing (SRI) and impact investing. In general, these terms describe investment strategies which focus not solely on financial gains but on social & environmental impacts on equal terms, too (GIIN 2014a). Different banks, NPOs, and funds developed rating systems to simplify the process of impact investing. One such rating system was developed by the Global Impact Investment Network GIIN. Their impact reporting and investment standard IRIS combines many performance metrics in order to help companies "to evaluate, communicate and manage their social and environmental performance." (GIIN 2014b.)

Rating systems such as IRIS aim at the social and environmental impact a company or bank has throughout all of their operations. This covers all products and services they offer, especially the question to whom they offer it (What does the borrower do with the lent money?), and from whom do they receive services (From whom do I get deposits?). So greenwashing processes, meaning that supporting one ethical project in order to make up for other unstainable processes the companies has, is not possible when doing socially responsible investing thoroughly. Still, rating systems like IRIS can be used by everyone, not only ethical banks & corporations. In fact, in 2011 assets under management (AUM) which followed at least 1 sustainable and responsible investment strategy totalled 3.3 trillion dollar in the United States. That is around 11% of all assets under management in the USA. (USSIF 2013, 11.) AUM refers to all assets a bank or financial institution is managing, that includes their own assets as well as assets they manage on behalf of their clients (Casu, Girardone & Molyneux 2006, 68). When considering that ethical banking and investment is still a niche segment, these numbers seem out of place. So what do ethical banks offer, which the majority of these 11% do not?

Elisabeth Paulet & Francesc Relano addressed this issue in the publication 'the twofold betrayal of co-operative banking'. They state that ethical intentions of banks can be categorised as "banks whose ethical/social approach is mainly based on what they say", "what they are", or "what they do". (2010, 1.) Paulet & Relano group most commercial into the first category (what they say). This group usually has good and detailed corporate responsibility (CSR) statements which they actively promote through their PR departments. However, the authors found a severe lack of commitment towards the banks own CSR policies. There seemed to be no practical implementation of the stated goals. (2010, 7.) Indeed, Deutsche Bank's annuals CSR report 2013 spans over more than 100 pages (Deutsche Bank 2014). Additionally, the bank publishes regular reports targeting responsible business, environment & society (Deutsche Bank 2014b). It is similar for the commercial bank Barclays which put social and ethical issues under their headline 'citizenship'. Their 50 page citizenship report is complemented by many pages of statistics, statements and interviews about the ethical behaviour of Barclays. (Barclays 2014.) If considering the high fines both banks had to pay in the past for ethical misconduct in their business (for instance by rigging currency rates) and still face at the moment; their actual ethical behaviour is highly doubted (Choudhury 2014).

The second category (what they are) is characterised as institutions which communicate their legal status as source of social and ethical business behaviour. Paulet & Relano focus on co-operative banks as representatives of this group. (2010, 1.) Co-operatives have by nature no shareholders and therefore do not aim for any TSR (total shareholder return). Being an entity based on membership, their responsibility is with their members. Most members are from around the social environment of the co-operative and therefore, co-operative businesses should naturally be more engaged in the wellbeing of the society. However, the authors argue that differences in co-operative banking and universal banking are diminishing for the last 25 years. By giving members and non-member stakeholders equal status (as clients), the special responsibilities co-operative banks had towards the society is declining. Ultimately that means co-operative banks social attitude is mostly based on what company form they have and not anymore on what they do. (Paulet & Relano 2010, 9.)

The third category (what they do) represents ethical banks. In opposite to the banking models of the other two categories, ethical banks' social & environmental commitment is expressed in the practices they do throughout all parts of their operations. (Paulet & Relano 2010, 1.) As described earlier in this chapter, ethical bank use a very high level of transparency and tools like the triple bottom line to maintain high ethical standards. They do not need long, CSR reports or statements, as their ethical intentions envelop the whole bank. CSR is incorporated into all of their features and thus, does not need to be lined out separately. (Paul & Relano 2010, 12.) Instead ethical banks utilise transparency in order to communicate their social responsibility. Typically, ethical banks publish information about their social and environmental criteria for loans, as well as detailed information about the ethical behaviour of their borrowers. At the same time investors can choose in which business areas they want the bank to invest with their money. Being transparent allows ethical banks also to use the public society as a sort of supervisor over their practices. If the bank violates their own ethical standards, the public will know about it and countermeasures can easily be taken. All in all, transparency goes throughout all parts of an ethical bank.

The difference between ethical banks, meaning the third categories, and banks from the first category can also be seen within their financial figures. A study by the Global Alliance for Banking Values, researching banks from 2003 to 2012, stated that ethical banks loan out a much higher portion of their total assets than the world's biggest commercial banking institutions do[1]. At the same time, compared to total assets, ethical banks' financial resources consist to 73.1% of deposits, whereas the deposit to total asset ratio for commercial banks is around 43%. (2013b, 3.) In consequence, these ratios show that ethical banks are less active on the money market and prefer to focus on the core activities of banking (lending and depositing).

After lining out what ethical banking means and how ethical banks are typically characterised, this work now explores what challenges ethical banks face.

2.3 Challenges of ethical banking

Ethical banking sector has enjoyed growth during the last few years. However, with opportunities come with challenges as growth goes together with higher risks. For ethical banks, keeping the business growing without damaging the integrity of their ethics and primary missions is crucial. There are several issues of management that ethical banks need to take into consideration if they want to evolve and enlarge their market share.

The first issue to be addressed is how the bank is managed as its business expands to reach a wider base of customers. The banks need to make sure that their new customers are well-aligned with the banks' principles and the banks should not change their ethical approach just to pander to their customers' demand. Second, ethical banks may gain customers from conventional big banks, who are accustomed to using high quality

[1] Ethical banks loan out as much as 75.9%, whereas the biggest commercial banks lend only around 40% compared to their assets.

and technically advanced services. Therefore, in order to remain competitive, ethical banks must keep up with new technologies to improve their performance and develop new products to avoid customer defection.

Another challenge for ethical banks is the management of an expanding business. According to Olaf Weber in his essay "Social Banks and the Future (and Past) of Sustainable Finance", many social banks originated from the grassroots movement and have functioned without any defined organizational structure (2011). This weakness will be exposed as the business extends its scope that involves a large employee base and bigger amount of resources. The banks have to create a clear cut organizational structure and develop good leadership to lead the companies to the right direction. The recent scandal about the Co-operative bank's failure is an example of when management went wrong. In spite of defining itself as an ethical bank, the Co-operative bank has strayed from its original ethical principles and engaged in various miscalculated investments in an attempt to broaden the scope of its business, such as the merging with Britannia – a building society that was facing a huge debt and investment in an IT project that resulted in £1.5 billion shortfall in capital. The series of misadventures were accentuated by a weak governance structure and poor management. (Kelly 2014, 4). They ultimately led to the bank's financial trouble, where Co-op Group (the original owner of the Co-op bank) had to forfeit the majority of their ownership to several US hedge funds whose primary interests are contrary to the core ethical policies.

As mentioned in chapter 2.2 "Characteristics of ethical banking", ethical banks should define themselves by what they do, a.k.a implementing operations that make real positive impacts on the people and the environment. Therefore, it is important for an ethical bank to have a well-established method of how they measure or estimate the social returns of their activities. This task can meet with a lot of difficulties since the impact can be calculated in arbitrary values. The methods vary from banks to banks, using different tools that have their own advantages and drawbacks. In this thesis, we tackle this challenge by examining the pros and cons of the measurement systems used by 3 social banks. After that, we propose a system comprising of two tasks: monitoring and measuring impacts of operations, in an effort to consolidate different approaches into a comprehensive guideline.

3 Methods

In this chapter it is lined out how the research was conducted, how the data was collected and why certain data was used for the report. This study uses the qualitative approach and as such relies on qualitative data collected for instance from interviews. It is specified who the interviewees are, which positions they hold and why they were interviewed.

3.1 Data collection

The sources for this study consist primarily of publications, both by independent researchers as well as by commercial and ethical banks. Ethical banking got its popularity only in recent years and as such not much literature about this topic is available. The authors used the few books written about the topic as a resource but mostly stayed away from news articles as they lacked in-depth knowledge. However, there is a good basis of publications by institutions and individual researchers which researched the topic of ethical banking, and their collections were of great use for this thesis. Major sources were the publications of Paulet & Relano as well as from the Forum of Sustainable and Responsible Investment USSIF and Global Alliance for Banking on Values.

3.2 Interviews

To support the analysis of the secondary data, 3 interviews were organised. The authors conducted interviews with representative of the 3 chosen banks. GLS and Triodos were chosen as research subjects for two reasons. First, the banks operate within the European Union. As the study is based in Finland, the authors were interested in analysing ethical banks behaviour within their own economic union. Although the banks are headquartered within the EU, their location and main business is in different nations. Triodos bank is headquartered in Zeist, Netherlands and GLS bank in Bochum, Germany. Second, both banks are major players in the field of ethical banking in Europe. As described before, both banks are one of the oldest and most established ethical banks. Therefore, analysing these two banks will validate this study in a greater aspect. The third bank, Charity Bank, was chosen for another reason. It is established in 2002 in the UK and one of the newer ethical banks in Europe. Most of its projects have direct impact on the community it is based in. Even though Charity Bank operates in a much smaller scale than Triodos and GLS with less experience, it has achieved outstanding results in terms of efficient investments that lead to successful social outcomes, building a loyal and satisfied customer base and getting acknowledgement from third party organizations for its ethical practices and social contributions. The authors chose this bank to analyse because for beginners in ethical bank sector (who are also the main readers of our guideline), Charity Bank case can be easier to connect with and learn from.

The interviewees were based on their position within the banks. For the German GLS bank the interviewee was Mr Stefan Möller, who holds the position of team leader of the credit division. As such, he is responsible for credit arrangement with the bank's customers as well as the supervision of the bank's credit operations. Therefore, he possesses most relevant knowledge and information to supplement this study. Mr. Möller assisted by answering a 45 minutes interview conducted via telephone at the 20th October 2014. The interviewee from Triodos Bank, Ms. S. is an HR Advisor. The interview was conducted in August 2015. Research on Charity Bank is done through secondary sources.

The interview questions for GLS and Triodos were mostly open-ended questions and based on 3 themes. The first theme covers the loan criteria the banks have. The second theme is about the banks monitoring processes for their borrowers and the third theme examines the impact measurement. To achieve comparable results both interviews and their questions were structured the same way. However, because of the different processes used by the banks some questions were changed, added or left out. A general outline including sample questions can be found as attachment 1.

3.3 Research process

The authors start by lining out the different services the chosen banks offers. With the service as a foundation it is shown shortly which ethical criteria are used to find suitable borrowers. Afterwards it is lined out in which way the banks monitor its borrowers to ensure that the agreed criteria are kept. This is one focus point of the thesis and aims to answer investigative question 3. Finally, it will be shown what measures the banks use to check if the borrowers' project complied with the set ethical criteria and standards at the end of its runtime. The research process can also be seen in figure 1.

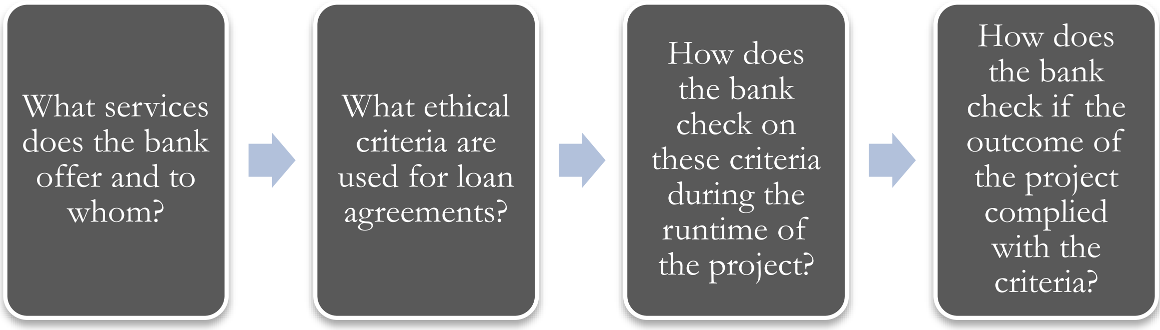

Figure 2. Research process

4 Overview of the research partners

Among the various ethical banks which developed in Europe in the last decades, the authors chose three of the best known ones for their research. Ethical banks exist in almost every member country of the EU. To permit valid comparison 3 banks of different countries are chosen. As main players of ethical banking the GLS bank of Germany and the Triodos bank of Netherlands are credible examples. Additionally, the British Charity Bank depicts the practices of banking in a small scale as a relatively new player in the field.

4.1.1 GLS Bank

The German GLS Bank is headquartered in Bochum, Germany, and considered to be the world's first bank following a strict social and ecological philosophy (Spitzeck et al. 2012, 109). GLS stands for Gemeinschaft für Leihen und Schenken [Community for lending and donating]. Like most ethical banks, GLS Bank is organised as a cooperative, giving it the official name GLS Gemeinschaftsbank eG. As a cooperative, it does not have shares in a way limited liability companies have. Instead, it is a member based ownership in which most members are customers, employees or other stakeholders. Currently, there are around 32,000 members. (GLS Bank 2014a.) Its recent turnover totalled to 3.2 billion Euros in 2013, an increase of almost 20% compared to the previous year. The bank reported a profit of around 200 million Euros in 2013. (GLS Bank 2014b, 5.) The bank labels itself as "human, forward-looking and economical" and strictly follows the 3 Ps of the Triple bottom line principle (introduced in chapter 1.5) (GLS Bank 2014c).

After Ingo Krampen and Wilhelm Ernst Barkhoff developed a non-profit banking structure in 1960, the GLS was officially founded in 1974 as an anthroposophical bank. After genuine growth, the bank opened its first branch office in 1982 in Stuttgart, Germany. In the following years the bank expanded on their ethical and environmental objectives, while including ecological agriculture and wind power into their portfolio. At the same time GLS merged with GKG bank (another bank with ethical objectives), and acquired other initiatives like the Ökobank (a bank focussed on environmental standards). (GLS Bank 2014d.) The bank saw significant increase in customers after the financial crisis. While other banks struggled to survive, GLS Bank grew by 27% in 2008 alone. Growth rates for turnover and customers are high since and peaked at 37% in 2010. (Spitzeck et al.2012, 107.) By focussing not solely on high profit rates but by investing in ethical and sustainable businesses, the bank could acquire many new customers which were left insecure by the practices of traditional banks. Recently, the bank won many business awards, like the Utopia award 2008, Sustainable bank of the year 2009, German bank of the year award 2010, 2011, 2012 & 2013, European Business award 2011 & Europe's sustainable bank of the year award 2013. (GLS Bank 2014d).

4.1.2 Triodos Bank

Triodos Bank is one the world's leading social banks. It was founded in 1980 in the Netherlands and since then has expanded its business in several European countries including Belgium, the UK, Spain, Germany and soon France. It was built on the principles of sustainability, meaning that the bank's mission is to use the money to support companies and institutions and projects that will bring positive changes to the people and planet as a whole. The bank's main operations comprise of banking, investment management and private banking.

During the last 5 years, Triodos Bank has experienced a healthy growth as a business and was not substantially affected by the financial crisis like most banks in Europe. The bank saw an increase in the net profit from 9.6 million euros 2009 to 25.7 million euros 2013. During the same time period, equity and total asset under management increased twofold, the same rate of increase as with the number of loans and funds entrusted. (Triodos Bank 2014b.)

Triodos also shows a healthy level of capital adequacy and liquidity. In 2013, tier 1 capital ratio was 17.8% and leverage ratio was 8.7%. Therefore, both exceed the minimum ratios required in the Basel III guidelines[2]. These figures reflect the bank's approach to achieve a lower but more stable return on equity.

4.1.3 Charity Bank

Charity Bank is a British ethical bank founded in 2002 with the backup of Charity Aid Foundation. It is the first non-profit bank in the UK and was registered as both a charity and a financial institution under the regulation of the charity commission and the financial services authority (James 2002). Its mission is to provide cheap loans to charities and social enterprises which do not have access to mainstream lending facilities. The bank attracts capital from social investors and takes deposits from socially conscious individuals and then will lend the money solely to social organizations in need. Its business runs in only two countries: the UK and Northern Ireland, with offices in Tonbridge, London, Cardiff and York (INAISE 2015). Charity Bank is a member of the Institute for Social Banking.

Compared to GLS and Triodos, Charity Bank operates in a much smaller scale and scoe as it is a relatively new player in the ethical banking sector. During its 13 years in business, the bank has approved a total of £200 million worth of loans to more than 1000 social organizations in the UK (Charity Bank 2014a, 13). It does not have a staff bonus scheme, a policy meant to encourage its staff members to dedicate their efforts and skills in exchange of salaries instead of chasing after hard sales targets. The Board and Chairman of the bank work and give time voluntarily without getting paid. (Charity Bank 2015a.)

[2] Basel III requires a capital ratio of at least 6% and a leverage ratio of 3%.

5 Monitoring and impact measurement of selected ethical banks

In this chapter it is outlined which methods ethical banks currently use to monitor their supported projects and measure their impacts. To achieve this, the authors analyse the behaviour of the 3 different banks which were introduced in chapter 1.4. A combination of secondary research and primary research will be used for all 3 banks. Linh Tran focusses her research on the Triodos Bank while as Hans Goebel researches GLS Bank. Study on Charity Bank is done as pair work.

5.1 GLS bank

All research regarding GLS in chapter 3.1 and its subchapters is done by the author Hans Goebel. This chapter will provide an overview about the services the bank offers, how it monitors its borrowers and its impact measurement.

5.1.1 Services of GLS Bank.

This chapter describes the services the GLS Bank offers to potential borrowers. That means projects which do want to receive financing, for instance in form of loan contracts. The author will not line out services it offers to private people who want to deposit money at GLS Bank as this is not part of the research objective. Instead, services to borrowers will be explored as well as answers to the question what kind of borrowers GLS Bank serves.

In 2013 GLS Bank offered financing to 23,318 companies and projects. The total financing amount equalled 1,660,477,000 Euro. The bank separates their financing services into 5 sectors, which are Housing, Energy, Education, Food and Social. All of the financed projects are located in Germany. In 2013 most of their financing went to the energy sector which totalled more than 560 million euro or 33.9%. Second are education and housing which summed up to 300 million euro in financing each (18%). This is followed by the social sector (290 million euro, 16.9%) while as 220 million euro were invested into the food sector (13.2%). (GLS Bank 2014e.)

Each sector is host to a different set of projects and companies. The housing sector includes alternative living concepts such as passive houses which are based on high energy efficiency and a low ecological footprint (Zeller 2010). It also includes financing the development of new ecological construction materials as well as the restauration of historic buildings. The energy sector aims at supporting all forms of alternative energy sources like wind, solar and hydropower and biomass. GLS Bank also supports the educational sector by providing financing for schools with progressive teaching strategies and for cultural projects whereas GLS' food sector targets ecological agriculture and wholefood production. The social sector provides financing to improve the position of socially excluded people. That includes retirees, drug addicts, minorities, and disabled people among others. (GLS Bank 2014e.)

GLS Bank prepared different services tailored to each of these sectors and its subdivisions. Instead of offering the same financing options to all sustainable businesses, the services differ to meet the special needs of each institution. Independent schools for instance may receive donations and state subsidies. However, the transfer of such is often delayed, and therefore, GLS Bank offers pre-financing for these expected inflows. (GLS Bank 2014f.) Additionally, GLS Bank offers a service called loan with break-even contribution for educational institutions. Instead of charging regular interest rates, GLS Bank only charges the costs for personnel and materials and a risk portion. They do not include any amount for profit making. Hence, loans will be given out at the break-even point from the banks point of view and offers cheap financing for their partner. The calculations for such a loan will be lined out transparently before a loan contract is signed. (GLS Bank 2014g.) On the other hand, for branches like the organic industry, GLS Bank will not only offer loans but tries to improve the business network of their borrower (GLS Bank 2014h).

In short, GLS Bank mainly offers financing through loans with different interest schemes. Additionally, they do invest in funds and shares of socially and environmentally responsible companies. Another service is microcredits tailored to entrepreneurs and small businesses. The bank states that who receives which services depends on each individual case. This includes certain criteria which we explore in the next chapter.

5.1.2 Ethical loan criteria at GLS Bank

When deciding to finance a certain project or company, GLS Bank follows a very concrete process with the Kriterienkatalog [criteria catalogue] at its core. This catalogue includes two lists, a positive criteria list and a negative criteria list. The items included on the positive criteria list are:

- "Social-ecological company values,
- social commitment,
- development goals,
- energy efficiency & renewable energies,
- resource efficiency,
- anthroposophical medicine, homoeopathy & naturopathy." (GLS Bank 2014i.)

Whereas the items on the negative criteria list include:

- "Violence of human rights,
- violence of basic liberty and labour law,
- child labour,
- animal experiments,
- controversial environment policies,
- controversial business practices,
- nuclear energy,
- biocides,
- organic mass production,
- embryo research,
- genetic engineering,
- pornography,
- military,
- addictive drugs" (GLS Bank 2014i).

When evaluating if a project qualifies for financing or not, the bank first checks if the projects' values and targets are aligned with the criteria of their catalogue. If the project includes any items of the negative list, it is automatically excluded from any financing opportunities. However, if it complies with items of the positive list, it qualifies for further research in a 3 step process. (GLS Bank 2014i.)

In the first step in-house specialists prepare a detailed study about the project or company. They use data from external rating agencies (specialised on sustainable businesses) and NGOs as well as conducting their own research. Analysis will be done for the business values, products & services and production processes of the company. As a second step, the prepared study will be compared to the criteria catalogue of GLS and based on the catalogue the bank will create their own rating of the project. This rating is the base for any decision for or against the project. As a final step the research team will reason the decision by creating a detailed report lining out the positive and negative criteria as well as economic factors which influenced the decision. It is important to note that research and decision are made by 2 different teams, in order to have 2 separate opinions while ensuring the objectivity of the decision. (GLS Bank 2014j.)

To define if a projects fulfils a certain criteria or not, is time consuming task. According to Mr Möller GLS bank uses different approaches to verify if a business acts according to their ethical loan criteria or not. For the banks agricultural sector, GLS bank relies heavily on certificates issued by third parties. This is a common process in this business area. Farmers can obtain certificates if they fulfil certain standards set up by independent organisations or union. They can later use that certified logo in order to market to investors and customers that they act within fixed ecological and ethical boundaries. GLS bank only provides loans for agricultural business which have at least 1 of the accepted certificates. For instance will GLS bank accept farmers certified by Bioland. (Möller, S. 20 Oct 2014.) Bioland is a German association which certifies producer of organic-food. Setting up guidelines for around 6800 agricultural businesses it is the largest association of its kind in Germany. (Bioland 2014a.) According to Ecolabel Index, the standards of Bioland exceed the requirements for organic food production of the EU (Ecolabel Index 2014.) Farmers who want to receive certification of Bioland need to constantly prove that their activities are ecological, economical and socially responsible. To ensure that business activities do not harm the environment and/or people Bioland set up 7 principles, which includes items like pollution of rivers and the expulsion of local animals. Farms certified by Bioland are constantly checked by the organisation for their compliance. (Bioland 2014b, 8.)

GLS bank does only allow a selection of certifications. The bank need to ensure that the organisations providing certifications do have standards which comply with the ones of GLS bank and that the organisation has sufficient resources to check if all of the companies they certified really comply with the standards. Therefore, GLS regularly analyses the credibility of the certificates and, as a result, may discontinue the cooperation if necessary. So it happened that businesses certified by Neuland were previously able to receive financing by GLS bank, but after a policy change they are so anymore. (Möller, S. 20 Oct 2014.) In general, the cooperation with certifications is very beneficial for GLS bank as it is much easier to check on the view organisations providing sufficient certification, instead of checking on each agricultural business by its own.

GLS bank works with certificates for its food branch, too. Accepted are businesses trading majorly with certified organic food and fair-trade labelled products. However, it would be almost impossible for retailers and wholesalers to only sell certified products. Therefore, GLS banks accepts traders which primarily (not exclusively) deal with certified products. There is no fixed percentage of how many products should be certified; instead it depends on individual negotiations. In its social, housing and educational sectors it is very difficult to work with certificates or similar measures, states Mr Möller. Due to its social nature financing for these sectors depends on the individual case. GLS bank provides financing for independent educational institutions as long as they ensure that nobody will be discriminated by race, gender, culture or religion. This comes close to how the bank handles businesses categorised within the social sector. Projects differ a lot from each other, so compliance with the ethical loan criteria needs to be checked case by case. The non-discrimination is a good starting point for further analysis. For its housing sector the bank uses a different approach. In general, all projects providing accommodation are supported by GLS bank. However, if the project can prove that it provides additional ethical benefits, like low-energy housing or housing for social disadvantaged people, it will receive bonuses in form of cheaper financing. Again, the bank needs to check each case by itself if the project is eligible for bonuses or not.

5.1.3 Monitoring process at GLS bank

This chapter provides information about the monitoring processes of GLS Bank. The term monitoring process refers to the checks GLS bank is doing on their borrowers, in order to control if they act financially and ethically according to the loan criteria set up by the bank. Other forms of monitoring and supervision, such as in-house monitoring, will not be part of this chapter, nor any other chapter within this thesis.

The decision if monitoring is necessary and how it should be done is greatly based on 3 factors according to Mr. Möller. The first factor is the volume of the credit. Credits covering a 5-digit or lower 6-digit euro value are mostly excluded from any monitoring activities. This is due to the low impact they have on the banks operations. The expenses, which effective monitoring would require, would not make for a relatively small benefit of supervising a 50,000 € loan. (20 Oct 2014.) Considering the recent growth of GLS, this is understandable. Total credit volume in 2013 rose to 1.64 billion €, an increase of 16.8 % compared to the previous year (GLS Bank 2014b, 18.) Taking these numbers, a loan of 100,000 € has only a marginal influence within the whole credit volume. Accordingly, it is very logical to apply monitoring procedures only onto loans spanning a higher 6-digit volume, in order to avoid misallocation of company resources. Instead, GLS bank standardised loans with low value to a great extent. Company staff together with the borrower will work with premade documents to ease the procedure. The documents do not vary very much between the different branches of business GLS is serving. (Möller, S. 20 Oct 2014.)

The second factor, influencing monitoring decisions, is the question if the borrower is a new or a regular customer. In general, new customers have a greater need of monitoring than regular customers. GLS bank seeks to contact new customers, who ask for high volume loans, face-to-face. These meetings would not only happen before any contracts are signed but also during the loan period, especially if the contract states that GLS will pay the loan in several instalments. For loans spanning large sums, it is common that the loan sum will not be paid all at once but split over a defined period. GLS bank would want to contact the borrower before the next payment is made, to reflect on what has happened, the past performance as well as the customer relationship. The meetings include points such as the progress of the project, usage of the funding and the need of further funding. If there is any inconsistency in the interpretation of financial and ethical standards between the two parties, they would come up during such a meeting and it is very easy to discuss them on the spot, in order to avoid complications at a later stage. For instance, it could mean that GLS bank would delay their next instalment until the borrower fulfilled certain obligations stated by the contract. However, it is not always possible to have face-to-face meetings with the borrower. This can be if the borrower is a foreign citizen or company, or if the borrower is a large organisation, which uses standardised processes to simplify their financing. In such cases GLS bank has to rely on phone conversations and e-mails. Regular customers are usually excluded from monitoring measures. Whenever a successful long-term relationship could be established, GLS bank trusts their customers financially and ethically. Contact with this group is mostly made for 2 reasons only. First, the bank wants to keep relationship alive and therefore sets up meetings or telephone conversations. However, this is for customer relationship reasons and not for monitoring. Second, legal provisions often require the filling of paperwork as well as custom-made advices from the bank. (Möller, S. 20 Oct 2014.)

The third factor is the branch of business of the borrower. The different branches within GLS bank have different monitoring practices. The energy sector is generally a high volume branch. The 3 most common projects the bank will provide financing for, within the energy sector, are the construction of photovoltaic plants (solar energy), wind power plants and biogas. All 3 of these (the bank has not done much with hydraulic power so far) require huge amounts of funding due to their expensive technologies and large range. As the production of electricity is a very crucial factor for a country, the German government established laws which assimilate and standardise the construction and the financing of power plants a lot, especially for photovoltaic facilities. Therefore, GLS does not have many opportunities to individualise the loan process for photovoltaic plants. This also restricts the need and the opportunities for monitoring, because monitoring construction and financing is done by the responsible state department. Due to the high standardisation, GLS bank has no or almost no face-to-face contact with the borrower. Contact happens mostly via phone and via the many required documents. (Möller, S. 20 Oct 2014.) However, this is not a bad point, as the supervision by the state reduces the responsibility of GLS and therefore, saves company resources. On the other hand side, biogas production is a sector which is less standardised and offers more space for individual negotiations and monitoring. Generally, GLS bank is very critical and sceptical about biogas production. Biogas itself is a viable alternative renewable energy. Nevertheless, there are 2 crucial factors which reduce the practicality of it. First, the burning of biogas produces emissions, which could, if exhausted in a traditional way, harm the environment seriously. Second, the planting of crops for biogas production may reduce amount of crops available for food production. The production of food is a core issue for GLS bank and should not be violated by the need of electricity. The bank needs to safeguard that any biogas facility seeking for financing is *(a)* treating emissions in responsible way and *(b)* ensuring that the production of energy does not limit the production of crop used for food. This needs to be ensured before loan contracts are signed but also during the loan process. Therefore, the bank will monitor biogas facilities very thoroughly. (Möller, S. 20 Oct 2014.)

Due to the social nature of projects within GLS banks education and social branches, monitoring for them is more personalised. Most social projects are of low volume and therefore, might be excluded from monitoring. If the volume is large enough to be of importance then monitoring will happen, mostly on a face-to-face base. GLS bank does not have guidelines for the frequency of face-to-face meetings, as this will be determined by the individual situation. This can be very different and case dependent as some projects might require more assistance than others. In general one might say that the larger the organisation the less cooperation and monitoring is needed. (Möller, S. 20 Oct 2014.)

Mr Möller stats that there are no general guidelines within the bank onto how the departments have to handle monitoring issues. It is all based on the individual experience of the employees and teams and their feeling of how close they think they have to supervise a borrower. Commonly, GLS bank does not require their loan partners to submit yearly or quarterly reports about the development of the project. The bank only cooperates with the people who take the loan. In the very most cases these are the financial managers of an organisation or the managing director / CEO. In some cases, when the loan exceeds certain volumes, GLS bank also needs the agreement of the shareholders or owners of the organisation or company. However, if the owner is not the person managing the project (and the loan), GLS bank will only work together with the managing director and not with the owner of the company. (Möller, S. 20 Oct 2014.) The owners of ethical projects have strong interest themselves that the project will turn out successful. Just like banks, the owners provide financing for their project, just not in the form of liabilities (a loan) but in the form of equity (shares). As both parties want to turn the project into success in order to receive return (interest for the bank, dividends for the shareholder), they could combine their monitoring and supervising efforts. This opportunity, however, was not yet explored by GLS bank and there is no plan to do so in the future. GLS bank considers their monitoring strategy as sufficient and effective. Still, it would be nice to see if cooperation between shareholders and creditor would boost the success of an ethical operation.

5.1.4 Impact measurement at GLS

GLS Banks impact measurement processes and methods are not lined out online, as it is the case for many other ethical banks. According to Mr Möller, GLS sticks to a more basic and linear approach regarding impact measurement. The core idea of GLS is to provide financing for ethical and sustainable projects. In practice that means for the bank that projects get evaluated thoroughly regarding the ideas of the bank before receiving any financing (compare chapter 5.1.2 ethical loan criteria). Additional, as lined out in chapter 5.1.3, there are monitoring processes which ensure that the project will develop in the right direction. However, as long as the ethical idea is distributed by the project, GLS does not see the need to further evaluate and measure the impacts of the individual project. That means, GLS bank measures impacts only for certain selected projects and not for every one of its clients. This has several reasons. The measurability of the project is one of these reasons. One conclusion from chapter ‘5.1.2 Ethical loan criteria at GLS Bank’ was, that is very difficult to set up fixed loan criteria for many ethical business sectors (such as housing and education). The bank has to work mostly with vague terms as it is hard to define boundaries for what is ethical and what not. This uncertainty affects also the impact measurement process of the bank. If there are no fixed criteria stated, it is very hard to define concrete measures for what impact a project had. It is impossible to have helpful impact measurement for a project which has no concrete loan criteria to follow and only vague units of measure. For that reason, GLS bank might skip impact measurement for such projects or use a more personal approach. Mr Möller lines out that evaluation often happens in personal meetings for projects in the educational and social sectors. These meetings are mostly about the personal feelings & impressions the project managers had of the project development during the loan period. Concrete impact figures are usually not part of the project as the focus is on keeping the personal network with the client alive. (Möller, S. 20 Oct 2014.)

In general, there is no impact measurement for small scale projects. The bank considers loans of 100,000 euro or less as small scale, similar to the handling of monitoring procedures. (Möller, S. 20 Oct 2014.) If a project is of considerable size for GLS and there are concrete measures available, the bank may measure the impact. The results are not published separately but are integrated into the company website. GLS Bank introduces are range of big projects financed by them online. If applicable the bank will publish the impacts these projects have within these project portraits. The bank will update these portraits regularly to ensure all information is up-to-date. For example, GLS is financing the co-operative Friedrich-Wilhelm Raiffeisen Energie Hohenroth, which is focusing on providing solar modules for private housing in Southern Germany. The bank was able to define units of measures for their projects, which are reduction in CO2 emissions (compared to traditional power production), and the kWp produced. KWp stands for kilowatt peak and it measures the maximum output power of a solar module (solar is future 2014.) Together with the co-operative, GLS was able to measure that one of their projects can achieve 67.81 kWp while another project is able to reduce CO2 emissions by 31.500 tons within 20 years. (GLS Bank 2014k.)

GLS Bank measures the success of their loan strategy on a company level, rather than consistently measuring the impacts on a project level. That means, GLS is collecting data on how many loans were carried out successfully within the time stated in the contract. Mr Möller says that over 90% of all loans are handled by the creditors without any delay or other complications. The remaining 10% are cases in which monitoring processes helped to turn the project into success. That means that for these projects small detours were necessary, in the form of additional financing or longer loan periods combined with extended redemption times. However, the financing of these 10% is also regarded as successful as in the very most cases the project could be stabilised. The amount of projects which actually fail and were not able to repay the loan given is insignificantly small for GLS Bank. Even more impressive is the feedback regarding misconduct in ethical behaviour of a project. Mr Möller states that he is working for GLS bank for many, many years already and he never had a case where a project was repelled by the bank because it could not meet the ethical criteria lined out in the loan contract. According to Mr Möller it is important for a bank plan and set up its initial decision and its criteria very thoroughly. The better job you do before signing the contract, the less work you have to do at later stages. These success factors confirm that the bank has established valuable processes for monitoring and impact measurement, which will help GLS Bank to continue its growth over the next years.

5.1.5 Advantages and disadvantages of GLS' monitoring and impact measurement practices

The previous chapter describe the internal practices of monitoring and measuring impact used by the GLS Bank. It is important for the authors to line out the advantages and disadvantages these methods and procedures have. The focus is especially on pros and cons for a newly started ethical bank, as this is the target area for the guidelines. In this chapter author Hans Goebel will line out advantages and disadvantages of the banks' monitoring and impact measurement practices. However, as the ethical loan criteria itself as well as the initial decision process play a big role thereby, the author will line out pros and cons of these factors, too.

An efficient monitoring process for a starting ethical bank has to have 2 main characteristics above others. These are reliability and cost efficiency. Reliability means that that process is reliable in finding loan partners which need assistance and help to turn their project into an ethical and financial success. Cost efficiency is necessary because most likely, a newly starting bank does not have many resources available to spend on monitoring. Therefore, it is very valuable that GLS Bank uses different approaches for different sectors, regular & new customers as well as for high & low value loans. The division between sectors ensures that each project receive monitoring tailored to their respective business. At the same time, the division between low value & high value loan contracts will ensure that no resources are wasted on projects which have only a small influence on the banks business. Nevertheless, as GLS Bank is a well-established ethical bank, their border between high and low value is at around 100,000 €, which is a very high amount for a new business. A new ethical bank might set their at a lower value. It is very similar for the separation between regular and new customers. The bank might save resources by trusting their regular and reliable customers. On the other hand new customers need a more thorough monitoring process to assure that they are reliable. However, a new starting bank will not have regular customers at the beginning as relationships still need to be established. Therefore, this point is less important for them.

GLS Bank does not have face-to-face contact with a lot of their clients. Low value contracts, standardised businesses and businesses for which direct contact is impracticable are excluded. This is of disadvantage for a new bank, which aims set establish relationships with their customers. Likely, a new bank will not have many business partners to begin with. In order to build up good customer relations, direct contact is recommended. That includes direct contact during monitoring processes. Even though the word implicates something different, the banks monitoring can appeal to their customers as well, as it brings benefits to both sides. Additionally, GLS does not measure the impact of all of its projects. While it is reasonable for a bank with a size like GLS to not measure impact of projects with smaller importance or influence, this would be a disadvantage for a newly founded bank. A new bank still has to find its optimal way to do business and its ideal way of operation. Therefore, it is essential to analyse outcomes of all its projects, including smaller scaled ones. However, it would be advantageous for a new bank to follow GLSs practice of reflecting on personal concerns and impressions instead of only evaluating projects in a form of calculation. Another disadvantage is the lacking cooperation of GLS Bank with owners or shareholders of a project, if they are not managing it. As described in a previous chapter, GLS Bank does not cooperate with the owners of a project if the owners are not directly involved or if they do not request the loan themselves. However, the shareholders have a very similar interest in a project as the bank has. They both want to have their return on the investment (the bank in form of interest payments, the shareholders in form of dividends). At the same time they want to be sure that the project fulfils ethical criteria. Environmental and social projects usually yield as smaller return than other more conventional investments. Therefore, it can be assumed that the shareholders, who are willing to engage in such an investment, are eager to see its ethical role performed in a good way. A bank can take advantage out of that and compare the ethical criteria of the shareholders to the ethical criteria the bank has. If they are very similar, both sides can save resources by aligning their monitoring & impact measurement approaches and only do once what otherwise would have been done twice (once by the shareholders, once by the bank).

5.2 Triodos Bank

This chapter is written by author Linh Tran with a view to explore Triodos bank's range of services, expertise in the field of ethical banking and their methodology in impact assessment. The chapter also goes into details about Triodos' lending strategy, which is constructed on a well-defined set of ethical criteria. Some of the information presented in this part is collected through an interview with a Triodos representative, Ms. S., from the Netherlands branch, who wished to remain anonymous.

5.2.1 Services and expertise

Triodos is committed to implementing financial activities that bring positive impacts on the community and the environment. The bank emphasizes on 4 key values: sustainability, transparency, excellence and entrepreneurship and incorporates these values into their operations. Triodos offers various financial services that can be classified into 3 categories: banking service, investment management and private banking.

The retail and business banking services are available in the Netherlands, the UK, Spain, Belgium and Germany. This is the biggest segment of Triodos business, contributing 78% of the bank's net profit in 2013 (Triodos Bank 2014b, 22). The services are offered to hundreds of private and business customers. Triodos finances projects only through funds entrusted and customer savings. The bank makes sure that loans are given to sustainable companies and projects which contribute to the improvement in the quality of life. Triodos focuses on 3 key areas (environment, social and culture) and evaluates their potential borrowers based on the added value they bring to these areas. The following chart shows that distribution of loans in different sectors. Overall, in 2013, the growth of the loan portfolio is recorded at 7.9%, equivalent of EUR 259 million increased compared to last year. (Triodos Bank 2014b, 24.)

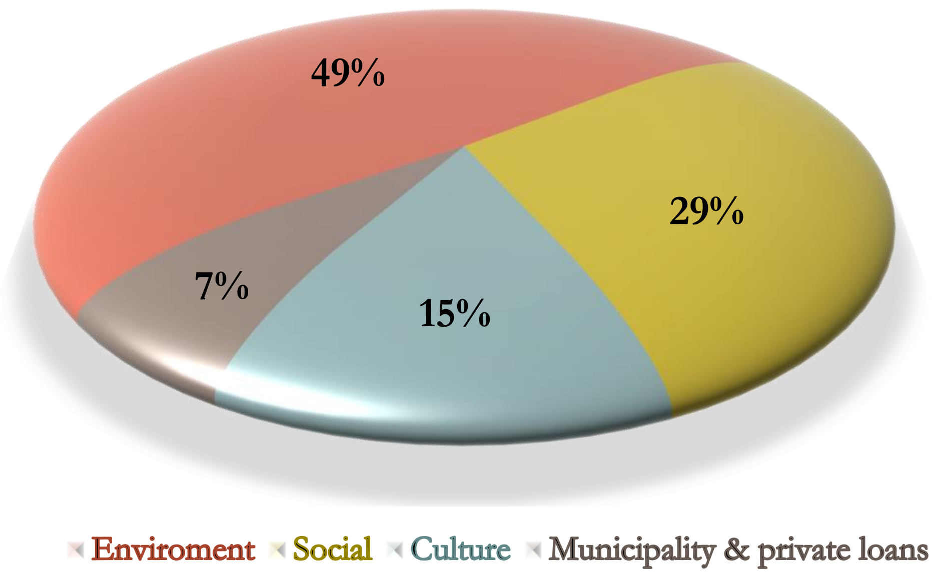

Figure 3. Outstanding loans per sector in 2013 (Triodos Bank 2014b, 22).

Investment management accounted for 18% of 2013 net profit. Triodos exercises impact investing through 19 investment funds with a sum value of assets under management of EUR 2 billion. The total amount of investment funds increased by EUR 317 million, a 15% rise from the year before. (Triodos Bank 2014b, 22.) These funds are divided into several groups, based on the nature of the investment: energy and climate, arts and culture, real estate, emerging market & social responsible investment. They are managed by Triodos Investment Management – a fully-owned subsidiary of Triodos Bank.

Private banking is Triodos' smallest business segment and is only available in the Netherlands and Belgium. The targeted customers of this segment are "wealthier people, foundations, associations and religious institutions" (Triodos Bank 2014c). The main service is sustainable asset management which consists of both investment funds and private asset management. As of 2013, the bank has enjoyed a growth of 17% of funds under management (Triodos Bank 2014b, 25).

5.2.2 Lending strategy

As an ethical bank, Triodos maintains a lending strategy strictly accommodating projects that will make positive and lasting impacts. Each branch has their own local credit committee, who are responsible for making the lending decisions based on the determined criteria and limits set by the Executive Board. The lending decisions might need reviews from the Executive Board who will determine if the loans exceed the limits or not. The bank also implements periodic checking for individual project based on several conditions including the creditworthiness of the debtors, the market in which the project is operated and the level of market exposure. (Triodos Bank 2014b, 102.) Triodos' approach to sustainable lending is as follows.

- Targeting sustainable sectors that need funds for innovation and improvement.
- Shortlisting projects whose outcomes can contribute to the positive changes in society, culture and environment.
- Assessing the capability and commitment of the people involved in the projects.
- Re-evaluating the shortlisted projects to see if they can meet the bank's ethical criteria.
- Determining the activities to be financed in clear terms.

- Performing thorough monitoring tasks regarding the usage of the loans as the projects move along. (Triodos Bank 2014d).

Triodos bank also has a transparent set of criteria called "Minimum standards and exclusions" used as the template for screening who they will lend to and who they will not. These criteria, which go into details about sector-based requirements for potential investments, are documented in a downloadable file on Triodos website.

5.2.3 Monitoring process

Triodos Bank's main targets of lending are small and medium sized businesses, institutions and charities. The main reasons for this policy are because it is easier for them to track how the loans are used and that they can keep a close connection with the investees. On the other hand, the bank also make investments in bigger businesses whose main focus might not socially- or environmentally-oriented but they play major roles in operating specific projects or assets that have direct contribution to the sustainable sector and activities. These investment decisions must go through a careful selection and monitoring process to meet the sustainable criteria laid out by the bank. (Triodos Bank 2014d).

According to Ms. S., Triodos Bank enacts a strategic policy called Active Engagement which aims to maximize the bank's influences on the companies they invest in. This initiative is meant to create a dialogue between the banks and their borrowers in a collaborative effort, seeking to raise awareness about sustainability, encourage positive changes and stimulate actions to ensure long-term shareholder value. The bank issues annual report on the Engagement Initiative which summarises the yearly results and outcomes of these engagements. In 2015, the bank has open dialogues 661 times with a total of 280 companies on multiple topics; the most discussed ones are arms, nuclear power, climate change, labour rights and animal testing. (Triodos Bank 2015, 4.)

The Active Engagement initiative consists of 5 phases: engagement during selection, providing feedback, monitoring the selected investment & widening engagement, voting for changes and shareholder collaboration. Triodos begins monitoring from the selection process. During this first phase, they send letters that contain information and questions needed for the assessment analyses to the companies they want to engage with. If the companies refuse to address issues or are short of a proper response, the bank might render them as ineligible candidates because of the lack of transparency. Phase 2 of monitoring process is providing the feedback. The companies will be informed about their assessment results and receive an overview of their performances and areas in main sustainable themes that need improvement. Triodos encourages companies to respond asking for more questions to further a smooth dialogue between the parties. (S. Aug 2015.)

The next phase includes monitoring of the investment universe and broadening engagement with selected companies. Triodos takes an active role in oversighting the investees' sustainability performances. For example, thanks to Triodos' proposal to increase its usage of renewable energy and production, a continuous effort since 2007, in September 2015, DSM announced their plan to purchase 50% of their energy from renewable sources and intend to boost this level to 100% by 2025 (Triodos Bank 2015, 5). Invested companies will have to go through a reassessment process every three years. During this phase, if there is a potential breach of Triodos' minimum standards, the bank will investigate thoroughly and join dialogue with companies in question to find a solution to the problem and help them with recommendations for changes to fit the bank's requirements. There are also a few cases where the companies fail to compromise and are subsequently removed from the bank's investment portfolio. (S. Aug 2015.)

The last two phases address Triodos' involvement as a shareholder, exercising their voting rights power to influence their investees' decisions for better sustainable outcomes. As per the 2015 Engagement report, they take part and cast vote in all 125 Annual General Shareholders Meeting (AGM) of the companies they loan to. As a shareholder collaborator, they often form partnerships with other shareholders with a shared vision on how they want to achieve the sustainable goals through the most effective actions.

5.2.4 Impact measurement method

Monitoring and impact measurement process go hand in hand and often overlaps. Triodos Bank has developed an intricate and detailed system of tools to measure the impact of its lending activities. The bank sets out to put a stronger emphasis on the qualitative evidence of their impact instead of just pure interpretation from numeric values (Triodos Bank 2014e, 222). However, the bank still employs a quantification-focused methodology. Ms. S. revealed, the bank has been constantly working on to what extent they can quantify the impact, a never-ending challenge. For instance, in terms of social impact, it is a difficult task to produce concrete figures of how many people are benefitting from Triodos' investments, but throughout the years the bank has managed to turn things from implicit to explicit, as observed from the increasingly detailed and complex methods reported in the annual impact statements. The bank also believes that the simple way of evaluating the growth of impact at face value is to take into account the growth of loan portfolio in sustainable investments.

Since the bank positions itself as one of the pioneers in social banking movement, it strives to exert its influence on the wider banking industry by promoting sustainability, diversity, and transparency. Therefore, other than assessing the impacts of its loans, Triodos also conducts a method to measure its own impact within the banking sector. The bank divides its investment into 3 major categories: environment (including 3 sectors: renewable energy, organic farming and food, sustainable property), social (social projects, healthcare and microfinance) and culture (arts & culture and education). Each sector uses their own set of metrics and indicators on which the evaluation of impact are based. Triodos also presents a key figure "impact per customer" in their annual report which is made on the basis of deposit per customer in all branches to reflect how much impact the bank has created on its customers in a given sector.

Banking sector

Global Alliance for Banking on Values (GABV), mentioned earlier in chapter 2.1.2, is a "an independent network of banks using finance to deliver sustainable economic, social and environmental development" (GABV 2015a). They developed a tool called "the GABV scorecard", a comprehensive template made up of basic requirements, quantitative and qualitative factors with short explanations, which provides stakeholders an inclusive view on the sustainability performance of individual bank and a basis to make comparison between the performances of different institutions. Triodos adopts the GABV scorecard to assess its own sustainability level. This thesis will not go into details about Triodos' data on the scorecard because it is beyond the scope of the project, but the main components of the scorecard are demonstrated as followed.

- Basic requirements: regulated financial institution, sustainability mission, reporting transparency.
- Quantitative factors: financial viability, real economy focus, Triple Bottom Line focus
- Qualitative elements: strategic direction, implementation, identifiable results. (GABV 2015b.)

Environment

All the investments related to environment are categorized into 3 entries: renewable energy, organic food & farming and sustainable property.

For renewable energy sector, in 2014, the bank used 28% of its total loans on this sector, the majority of which went to solar and wind energy projects (Triodos Bank 2014e, 245). Quantitative indicators include annual figure of projects financed, megawatts (MW) of energy generated, the electricity needs equivalent of how many households, figures for CO_2 emission reduction, average energy use per kWh per household, etc. Triodos calculates the emission reduction based on the conversion rates (kWh gram CO_2) from Greenhouse Gas Protocol Initiative which is part of the IPCC (International Panel for Climate Change) report. (Triodos Bank 2014e, 247.)

In regards to organic food and farming sector, Triodos focuses on supporting farmers who advocate the practices of sustainable and organic farming and have high consideration for animal welfare standards. The bank adopts The Ecological Footprint method, developed by the Global Footprint Network, to estimate the number of people who could be fed by the products produced by organically farmed lands financed by Triodos.

Sustainable property sector makes up for 9.4% of loans, in which the property development subsector accounts for the majority of 62% (Triodos Bank 2014e, 256). Triodos finances projects that utilize available technologies to build and renovate sustainably-designed properties that consume less energy and has lower carbon emission. For the impact measurement purpose, the bank uses these main indicators: the number of homes financed and commercial properties, meter square of office and commercial space enough for how many people and hectares of conservation/nature land. In the calculations, it is assumed that the average floor space per worker is 20 m^2. (Triodos Bank 2014e, 260.)

Social

The social sector has the second highest percentage of loans in 2014, claiming 26% of Triodos loan portfolio. Charities, social enterprises and any values-focused organizations whose primary objectives are to improve the living conditions, providing better healthcare and offering more employment opportunities for vulnerable people are all the targets of support from Triodos.

In 2014, the bank made loans equivalent of EUR 97.1 million to 585 social projects. An addition of EUR 336.8 million were invested in social housing associations, providing accommodation for 9300 people. (Triodos Bank 2014e, 273.) The figure of people accommodated is calculated based on the volume of lending divided by average unit cost. All the calculations are made under the assumption that the bank contributes approximately 70% of the borrowing for each project. (Triodos Bank 2014e, 279.)

The healthcare sector accounts for 12.3% of loans with the majority of the investments go to care services for the elderly and special needs. The number of projects financed, the number of people benefitted from such projects are the key metrics for impact assessment. Triodos' lending activities have resulted in 20,000 individuals received services at 249 care-for-the-elderly projects. In simpler term, each Triodos customer is financed 13.8 days of care. Again, Triodos reports 100% of impact in projects it co-finances. (Triodos Bank 2014e, 285.)

Lending to microfinance sector is within the responsibility of Triodos Investment Management (TIM) – the impact investing subsidiary of Triodos Bank with a total value of EUR 3.1 billion. It has 18 sustainable funds under management, one of which specializes in microfinance sector. In 2014, the branch provided loans to 102 microfinance institutions in 44 countries, reaching out to 8.4 million savers and 11 borrowing clients. (Triodos Bank 2014e, 286.) The impact from microfinance activities is measured on the basis of TIM's Emerging Markets Sustainability Management System. This tool takes into account the variety of microfinance institutions Triodos make loans to, drawing conclusion from quarterly reports, annual reviews and on-site visits.

Culture

Percentage of loans for cultural projects takes 14% of total loans according to 2014 report. Art and culture projects make up for 6.1%, whereas education investments accounts for 3.4% with the rest goes to other cultural efforts. (Triodos Bank 2014e, 261–268.)

As one of the leaders in the arts and culture sector, Triodos has provided 433 loans to arts and cultural organizations which facilitate 6.2 million visitors to enjoy cultural events (Triodos Bank 2014e, 262). The bank also created Triodos Cultuurfonds fund specifically for its Dutch clients. With regards to impact methodology, the institutions financed by Triodos will submit their annual data of the number of people attending events, visiting shows and watching films to the bank. In case the figures are missing or not available, the bank uses an average number of people attended a particular event of a project during that year and then multiplies it by the number of events the project has accomplished. In education sector, 2014 figures show that about 821 500 benefitted from 857 educational institutions and programmes financed by Triodos (Triodos Bank 2014e, 267). The number of people educated in the educational establishments invested by Triodos is the key indicator for impact evaluation. The bank claims 100% impact in projects it co-financed.

5.2.5 Strengths and weaknesses of Triodos Bank's method

Triodos' method of impact measurement shows a high level of transparency and clarity which is an acknowledgement to their core value. The impact statement reports information about annual investments on sector level, with concrete figures about the number of projects and the amount of loans for each sector. The bank does not hesitate to use straightforward and specific quantitative metrics to measure their outputs and outcomes, which is a resource-demanding approach. The strongest point of Triodos' method is that it produces concrete results which can be easily comprehended and interpreted by stakeholders and outsiders alike. It also gives stakeholders' an overview of the bank's performance and the impact it makes during the year.

On the other hand, there are still some weaknesses within this methodology. One major weakness is that it leaves no possibility for a performance comparison across sectors because each sector has their metrics based on which the impact is measured. Therefore, an improvement could be made with the addition of a more general, high-level metrics that can be applied to different sectors beside the usage of sector-specific metrics. Moreover, there is a certain portion of the portfolio not taken into the scope of measurement due to the difficulty in navigating through the variables to determine the impact of such projects. (S. 2015.) Another issue is about the co-financed projects where Triodos claims 100% impact. This leaves the question whether Triodos overestimates or underestimates their contribution.

5.3 Charity Bank

Charity Bank prides itself as the only UK bank to be granted the Social Enterprise Mark – an international social enterprises accreditation awarded to businesses with proven ethical and credible practices and motivations. It is also a certified B Corp bank (B Corp certification is to companies the equivalent of a Fair Trade guarantee to products) and is the first of its kind in Europe. According to a 2014 customer survey, it is reported that 99% of the respondents would recommend their acquaintances to use the bank services, showing a high level of customer loyalty and satisfaction (Charity

Bank 2014b). As of 2016, the bank also ranks third in ethical cash ISA index (Individual Savings Account) published by Ethical Consumer organization (EC 2016). What is the reason for the bank to gain such trust from their customers and get recognition from third parties alike? In this section, we will delve into the bank's operations and services, its lending policy, monitoring and impact evaluation processes.

5.3.1 Services of Charity Bank

Charity Bank's service consists of only two departments: loans and savings. Loans range from £50,000 up to £2.5 million. An exception is for social housing providers who can apply for a loan up to £3.25 million (Charity Bank 2015b). In some cases, Charity will work with other social lenders to provide a larger loan for their customers. The bank arranges and customizes the terms and repayment schedule for different borrowers in the way that works best for them. On the savings side, the bank offers socially aware customers a service that will earn them a fair return and an assurance about how the savings will be used for social causes. There are 4 types of products: savings account, community account, ethical cash ISA and children's small steps account. (Charity Bank 2015c.)

5.3.2 Lending strategy

The majority of the bank's borrowers are small but well-established organizations with a good track record. For example, scout groups, youth clubs and village halls are among the potential investees, despite their small size and scope. These organizations might struggle to get funded from high-street banks otherwise; therefore Charity bank will reach out to help them with the funding as long as the projects are working towards a social mission.

Borrowers of bigger size are often housing associations whose objectives are to construct and improve more affordable housing for low-income people and to partly alleviate housing crisis in the UK. Charity Bank also tends to give loans to organizations with good track records and good governance. On the other hand, the bank refuses to lend to start-up companies even though they might have high social impact due to the lack of proven track record.

Charity Bank's lending strategy can be characterized as impact prioritized, limited in scope, cautious in selection and low social impact risk. As a result, the bank has very low loan loss rate (only 0.4% of total lending since 2002) which indicates its ability to execute successful lending. (Charity Bank 2015d, 7.) It is understandable they choose this approach because the bank itself is small in scale so it will be difficult for them to handle big projects and micromanage the monitoring and the impact assessment processes within its resources with a satisfying result.

5.3.3 Monitoring process

When the loan agreement goes through, the bank starts a discussion with their borrower about which key performance indicators (KPIs) to use to assess the loan's impact performance. The borrower is obliged to report to Charity Bank on these KPIs. The KPIs differ from one project to another. Here are a few examples of the KPIs that have been used in the bank's previous lending projects:

- The number of people benefitting
- The demographics of people benefitting
- What are the outcomes resulted from the borrower's interventions? (increase of people accommodated that year, how much renewable energy is generated, etc.) (Charity Bank 2015d, 12.)

Charity Bank admits that the outcomes are difficult to put into quantifiable terms, for instance, the improvement in well-being. The bank maintains that the KPIs are employed as the starting points for further discussions about impact goals of the projects but should not be treated as hard targets to impose upon the borrowers.

For each borrower, the bank assigns a scorecard as a means to keep track the borrower's ability to reach the goals and to have a better understanding of different aspects of the borrower's activities. After the annual review, the bank will determine whether or not the project has failed to reach, achieved or surpassed the expected outcomes. (Charity Bank 2015d, 12.) The scorecard is also updated yearly so that changes can be tracked more accurately. Additionally, the bank takes feedback surveys from the investees and conducts interviews so that the parties can together work out the benefits and the problems of the loans.

5.3.4 Impact measurement method

Charity Bank does not focus on any particular sectors; rather the loans are allocated wherever there is a demand in the social sector. Therefore, the bank has a diverse loan portfolio, ranging from arts, community, environment, education and training, faith, health and social care to social housing and sport. The bank's impact measurement method is divided into two stages: initial assessment (or in our thesis referred as "Initial decision") and assessment review. Charity Bank has a similar approach to Triodos in the way that both banks measure the impact of the loans on a project- level rather than a company-level like GLS.

During the initial assessment, there are 3 aspects of the borrowers that the bank considers to be the most relevant: mission focus, organizational capacity and financial resources. Mission focus concerns questions about whether the organization has a clear idea about its objective, what kinds of activities it will undertake to complete the mission, who are the beneficiaries of their project and to what extent are these beneficiaries involved with the organization? Is the organization willing to learn and improve?, etc. Organizational capacity raises concern about the capability of the people and system of the organization. Lastly, the bank examines the financial resources of their borrower to check if they have enough finances to go through with the future endeavours. (Charity Bank 2015d, 10.) Once these 3 aspects are comprised and analysed, the information will be profiled into a scorecard – a scoring system developed by the bank to help the bank not only to understand their investees better but also to figure out if the organization has the ability to carry out the mission with success. Charity tailors the scorecard designs for each borrower to fit their capacity, goals and nature of the investments. An important element featured in the scorecard is how the borrower measures their social impact. By knowing the method of the borrower's selfassessment, the bank can have a clearer picture of the borrower's motivation and willingness to learn and improve, as well as come up with an appropriate method of measurement that works for both parties. Another factor that influences the bank's decision making is risk potential. Charity Bank takes into account two types of risks: financial risk (an organization's financial position and its ability to repay a loan) and social impact risk (an organization's ability to deliver expected impact results).

The latter stage of the process is assessment review. Like other ethical banks, Charity employs a range of measurement methods and metrics to assess the impact of the loans, which varies from one organization to another. The method chosen will have to be suitable with the organization's size, mission and complexity. The bank takes into account 3 factors before making decisions:

- The timescale factor: the intervention can have either an immediate effect on the beneficiaries or the effect will appear after a period of time or even present over a lifetime. For example, direct investments including housing, job creation or funding art projects result in immediate impact while a loan to a borrower to help them improve a computer system or to rent a better office space which lead to higher productivity and satisfaction of the workers will require a certain time period for the positive impacts to be seen.
- The scope of the benefit factor: this factor raises question about what is the limit of the benefit should the bank measure. Should only the direct beneficiaries be accounted for or does the benefit extend to friends, family and wider community?
- The qualitative/quantitative factor: should the measurement method focus more on quantitative or qualitative values or try to balance both sides? (Charity Bank 2015d, 11.)

Another indicator used by Charity Bank to evaluate the borrower's impact is the income. This indicator does not apply for every company; however, it is useful when it comes to certain types of borrowers, such as organizations that depend on grants. From Charity Bank's perspective, a stable income does not signify such organization's capability to provide necessary and useful services to the people, but rather a way to work on a minimum to keep its funders appeased. So in other words, Charity Bank argues, income can be construed as a factor that goes hand in hand with how well the organization performs to achieve its goals. (Charity Bank 2015d, 11.)

It is worth mentioning that prior to the 2013 and 2014 restructure of capital, the bank used a grid square figure to illustrate the impact of a single project using 4 indicators as the basis of the measurement: mission focus, organization resources, financial resources and wider impact. For comparison purpose, the current measurement method employed by the bank still uses 3 of the indicators, but for initial screening instead of for the later measurement stage. The figure is shown below.

Figure 4: An example of how Charity's obsolete impact measurement tool was used.

The above figure is an impact evaluation of the Lyvennet Community Trust Housing Scheme loan in 2011. The blue area represents the overall impact of the project. The indicators are given a value from 0 to 30. How the bank came up with the values to assign to each indicator is not explained clearly. The advantage of this tool is that the bank can easily compare the impact of different projects at face value just by looking at the size of the blue area. The value of each indicator also gives the bank an idea about which department performs well and which one is lacking. Another advantage is to help the bank to make comparison between the performances of different projects. That being said, there are too many glaring issues in this assessment model to be ignored, such as the arbitrary value assignment, the ambiguity of the choice of key indicators, the accuracy of the scale (because not all indicators can be measure on equal footing). The method had gone through several revisions before Charity Bank decided to discard it in favour of a specific project-based approach. From 2013, instead of using the same measurement method for all projects, the bank opts to change its methodology to suit the nature of each project.

6 Guidelines & discussion

In this chapter the authors will transform their findings to design guidelines as described in the research objective. The guidelines are aimed to assist people who plan to create a new ethical bank. The target is to combine the findings of both authors. Therefore, Linh Tran and Hans Goebel worked together for this chapter and its subchapters.

We first give an overview over the perspectives, outline and aim of our guidelines. That includes the benefits an ethical bank gets from it as well as the boundaries of its use. Afterwards, we focus on the 3 focal points which we introduced in chapter 1.2 'Research problem and investigative questions', which are initial decision, monitoring as well as impact measurement.

Our research is not destined to answer the questions of impact measurement once and for all. There are areas the authors had to leave out of this study and we encourage other researchers to take our study as a source for future investigation. Accordingly, the authors provide suggestion for future research in this chapter at all. Finally, we will assess our own learning as well.

6.1 Guidelines to monitor and measure the impacts of ethical banks' operations

In this chapter we provide an overview over the guidelines we designed. The guidelines are designed to offer a structured and well organised outcome to the research based thesis. As such, they are not shaped to meet the requirements of a project based research but more as guidance to the research.

6.1.1 Initial decision

Initial decision, as stated in earlier chapter, is the preliminary stage of the larger impact measurement process. The results of impact measurement directly reflect the effectiveness and rightfulness of the initial decision. This is the stage where the company has to establish the lending criteria and develop a framework for screening potential investment opportunities.

The first step concerns the construction of a set of criteria for lending that represents the overarching impact goal of the bank. These criteria serve as the driving force to steer the investment portfolio to follow the direction the bank sets on. These criteria have to be, first and foremost, in alignment with the mission of the bank. Furthermore, the bank needs to identify who the beneficiaries – the people whose lives you aspire to change – of their investments will be. It is necessary to do research on your targeted beneficiaries to know what the contexts of their situations, what their needs are and which aspects of their lives that need your interventions. Once the beneficiaries are determined, it is easier for the bank to recognize which projects will be or will be not qualified to receive loans on the foundation that which projects will have positive or negative impacts on the well-being of the bank's intended beneficiaries.

The second step concerns the development of a screening framework. The better the screening method, the better the results of investments will be. First, the bank rules out the obvious cases that do not comply with their lending criteria. The key word here is "obvious", because the more complex the criteria (for example, Triodos' exclusion terms), the longer it takes the bank to verify whether an organization violates one of their terms. Therefore, the necessity for further screening practice is called for. With a shortlist of potential projects lining up, the bank can use a scorecard method to rank investment opportunities (Charity Bank also uses an in-house scorecard system but for monitoring process instead). In this system, the investees and their projects are evaluated based on quantifiable results in terms of impact and financial considerations. In addition, bank has to take into consideration the impact risk factor. The bank should be aware that impact risks can take different forms. Even if an intervention is successful and beneficial to the people who are directly involved with the projects, the investment might cause displacement of other positive outcomes, undermining its total benefit. For example, a community housing project brings out visible social impact, but if the construction area disrupts with the habitat of native species, the bank will have to reconsidering the decision to fund this project or not. Beside its own evaluation of the potential investees, the bank can also utilize available public information and ratings figures from third-party organizations to strengthen their analyses. There are many rating agencies and data providers such as Eiris, MSCI, Oekom, Sustainalytics (ESG-focused)[3] and GIIRS, MicroRate (impact-focused) who offer useful information to judge the quality of an investment.

6.1.2 Monitoring

The monitoring process is of special importance to a new ethical bank. It aims to not only to detect and adjust financial and ideological problems as the authors described in previous chapters. It also offers the chance to improve customer relationship and receive feedback to how the bank is operating and organised.

The authors advise to handle the monitoring process in an open and flexible manner. That means monitoring should be done in a dialogue form in which the bank does not strictly require their financial and ethical measures to be fulfilled by the client. Instead, the bank should discuss current standing, upcoming challenges and future goals with the client and assist with finding solutions in case the client is struggling to cope with the criteria set up by the bank. As introduced in chapter 5.1.3, established ethical banks like the GLS have very firm monitoring rules which, in several cases, are demanding fixed measures from the client instead of considering very case independent. That is necessary in order to handle the vast amounts of financial contracts signed by these banks. This offers a niche for a new bank which does not have to cope with a big amount of loans to begin with. Cooperating with the client more closely during the duration of any loan agreement will help the bank to establish itself on the market.

Newly founded banks have usually very limited resources, much more limited than established banks. Therefore, it is advised to very carefully plan for which projects monitoring processes have to have larger focus and which projects can be handled without much capital allocated to them. As such, categorising projects and clients into

[3] ESG, standing for **E**nvironmental, **S**ocial and Corporate **G**overnance, refers to the 3 main factors that social investors use to assess the ethical and sustainable impact of an investment.

different groups (similar to how GLS Bank) is helpful. Naturally, a bank will classify loan agreements according to their principal of debts or loan amounts. Small scale projects have not only a smaller financial influence onto the banks business but are also likely to have only small influence on the banks public perception. It can be assumed that a loan only spanning a lower 5-digit credit amount is taken mostly by small, family businesses. If they fail to meet the agreed ethical criteria, it will have no significant effect on the social and ecological environment. Additionally, it will most likely be of no importance to the public reception of the ethical bank. For these reasons, monitoring practices can be reduced to a minimum for a small bank. It depends on the bank and its available resources to determine what credit amount it is considering too small to monitor. As an idea the authors propose a principal of around 50,000 €, but a bank might want to locate the decision around a different sum, or have several breaking points instead of only one.

It could be useful to set up categories for different industry sectors the bank is providing financing for. At the beginning a bank might only serve a few sectors, therefore differentiation should not be too detailed but suited to the bank's needs. The business could for instance be split between socially focused clients and environmentally focused clients. Therefore, the team could specialise to the needs of their respective faction and share knowledge between the clients of their group. If a bank decides to only focus on one industry to begin with, there is no need for segmentation. However, it might be considered once the bank starts to expand. It is very similar when considering the differentiation between new and regular customers. As a new bank will only have first time customers to begin with, they have to adjust to the segmentation a bit. It makes sense to evaluate monitoring efforts according to the overall impact a client has with his project. Publicly known clients should be preferred in the monitoring process. If such a client goes unmonitored and his project fails to meet the standards set by the bank, it is likely that it will have influence on the public opinion of the ethical bank. Therefore, the project will not only leave a negative mark on the triple bottom line of the bank but also hurt its reputation. On the other hand side, the bank can boost its own name if it successfully oversees clients which are known to a greater extend. Other reasons for segmenting customers for monitoring are of a marketing point of view and will not be evaluated further. Such reasons might be to extend monitoring on clients with high potential for further contracts or to enhance your brand.

Once the bank decided about its dedication to monitoring, it must determine which form of action it will take. As mentioned at the beginning of the chapter, the authors advice a small ethical bank to keep monitoring on a rather personal level. Clients the bank wants to focus on should be visited regularly. There should be meetings or at least phone calls about the current standing and future development. The timeframe for these meetings could either be on a milestone basis, meaning whenever the project reached a milestone there will be a discussion about it. On the other hand side, it could also be in certain intervals like every 3 or 6 months. It is recommended to ask the client to prepare small reports about the project over the period of the financing. This will help to keep expenses low by relocating monitoring efforts to the client. It is to note, that this should not be the only monitoring for important contracts as it is very easy for clients to deceive the bank about the real progress in their own reports. Nevertheless, it is efficient and should not be missed out on.

If the project has a physical, tangible part (like the construction of a low energy house or support of an independent school), it is recommend to visit the place routinely. This is in order to get a differentiated opinion of the project, which is less dependent on the client. These visits can be complemented by own research done by the bank. For a small bank it might be rather expensive to set up an own research team which helps to monitor clients. However, the bank should consider it if the project is crucial enough. This research could lead to an own report about the project in contrast to the one prepared by the client.

Monitoring should include a third opinion besides the one from the client and the bank itself. In many cases it might be helpful to contact a third party into the monitoring process. This third party can be of different nature. For instance, the bank could arrange an independent researcher to study the stated project. However, this is not recommended for a new bank as it is likely to be cost intensive and requires resources the bank might not be able to spare. Better third parties might be interest groups like environmental and social organisations which might have their own interest in the project. This saves resources for monitoring as the organisations have not only expertise in the field of business but might have material about your client's project already. In any case, there are often less resources needed by involving an ethical organisation, like a non-profit organisation (NPO). On the other hand side, the bank needs to make sure the interests of these organisations are in line with the banks own principles. Often there will be differences which are not critical, but still should be noted. Additionally, the bank should be aware that NPOs focus on environmental or social impacts of the projects. The financial part of the monitoring are likely not be touched by them but need to be done entirely by the bank itself. Another suitable third party could be project owners. As described before, projects are often set up and internally financed by institutions which are then not much involved in the actual managing and execution of the project. They represent internal financing as shareholders in opposite to the bank which is an external lender. However, both parties do have similar interests. Both care about the financial success and in the case of an environmental or social project the shareholders will care about the ethical success as well. Therefore, it is recommended to the bank to cooperate with this group of owners or shareholders. First, they might be able to provide further insight into the project as they are often closer to it than the bank. Second, through their legal status they have a stronger influence on the project. In case there are conflicts to the ethical principles noted during the monitoring process, the owners can easier root out the cause and influence changes. It is to remember that some small scale projects are independent and do not have an organisation behind it. In this case the owner is the project manager and therefore, should not be seen as a third party.

Taking the input of these 3 sides, the client, the bank itself and a third party, the bank can establish effective monitoring. It is visualised by figure 4 below. As seen and described this three-sided approach roots out distortions caused by any of the sides. In case the client provides inaccurate feedback about his project, the bank will notice it from the discrepancy from its own research and from the third party. Furthermore, because of the cooperation during the monitoring, the client may raise its voice if it feels that the feedback from a third party is unjustified. The authors also cared about the cost efficiency of the monitoring. Even though the process does involve 3 different parties, its aim is to be practicable for ethical banks with low available resources.

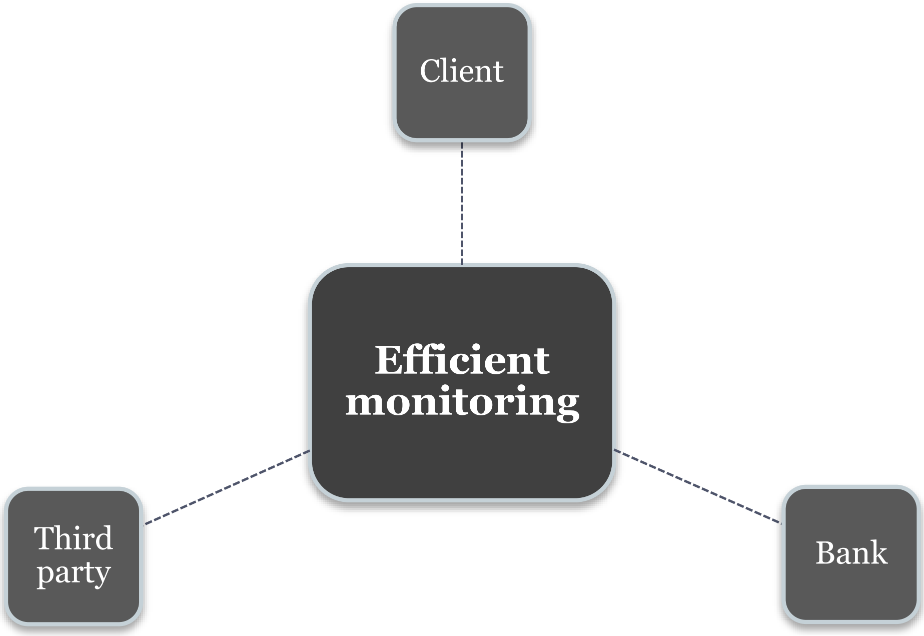

Figure 5. Efficient monitoring.

In case the bank decides to only locate few resources to monitoring a specific project, the bank has to spare out some of the steps. The authors recommend keeping the contact to the client but limiting it to milestone reports provided by them. Additionally, the bank could scale down its own researching and rely more on information provided by project owners or shareholders. The decision, which steps to leave out, depends largely on the individual project and must be taken by the bank itself. The authors only favour to not rely on 1 party alone but to take at least 2 of the above mentioned sides into the process.

6.1.3 Impact measurement

As detailed through three cases of ethical banks examined in this thesis, there is no certain way to have a 100% effective impact measurement method and it depends on the scale, scope, vision, goals and policy of each bank to develop their method of impact assessment that suit their needs. The guideline the authors of this thesis develop is not meant to tell the bank what the exact methodology they use, but rather how to build their own framework of impact measurement that incorporates different types of indicator metrics, step by step.

Step 1: Set investment goals and draw up an impact chain

The terminology used in this chapter is based on the Impact Value Chain theory. Introduced in 2002 in the research paper "Double bottom line project report: Assessing social impact in double bottom line ventures; methods catalogue" by a group of authors, the concept has since then become a popular referential foundation to define and evaluate social impact. It gives a general idea of a measurement framework and clarifies the differences between inputs, outputs and outcomes and impact.

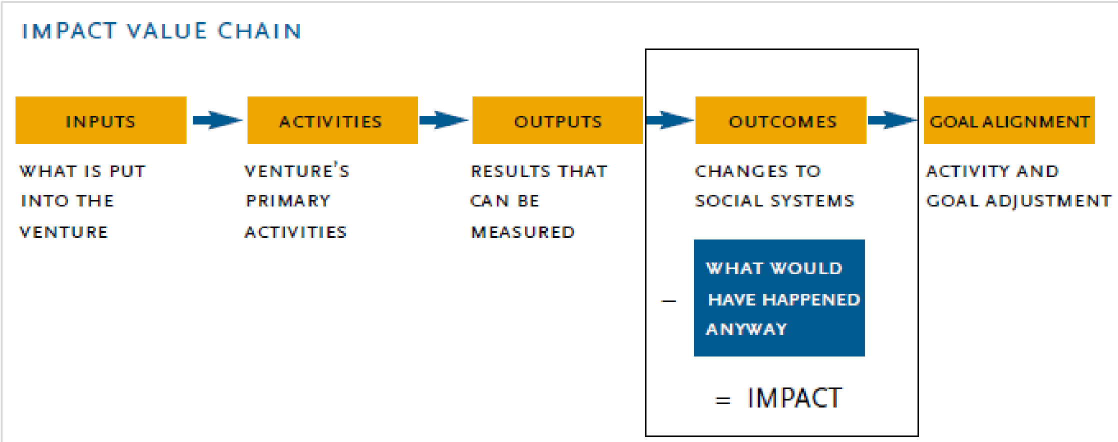

Figure 6: Impact Value Chain (Clark & al. 2004).

Inputs are everything needed by an organization to run its activities, whether human resources or capital. Outputs are the "results that a company, non-profit or project manager can measure or assess directly" (Clark & al. 2004, 6). Outcomes are the social or environmental benefit resulted from the outputs of an organization's activities. Lastly, impact is the positive social and environmental change made by the investment. Here is an example to illustrate the differences between these concepts, Charity Bank reports about its impact in the social housing sector with the following figures (Charity Bank 2016):

- Total loan value: £32,864,903 (inputs)
- With the help of Charity Bank, the borrowers are able to: (outputs)
    - Make available 380 new affordable homes
    - Refurbish 226 affordable homes

– The beneficiaries of the projects (outcomes)
    – 386 people moved from temporary to stable accommodation this year
    – 112 people were helped to manage in their own homes

The outputs are the services delivered or the goods distributed, to name but a few. These tangible or non-tangible products themselves are not what constitute the impact. Impact is born through the way these products are absorbed into people's lives and subsequently make changes – the outcomes. The outcomes represent the investment's real impact, while the outputs show the mechanism of how impact is created. An impact chain is considered good if it is a) logical and sensible, b) able to address the change for beneficiaries and timescale for the change, c) supported with performance results of previous investments and d) able to acknowledge other contributing factors. Here is an example of well thought out impact chain drafted by Leapfrog Investment – a private equity investment firm specializing in emerging markets financial services.

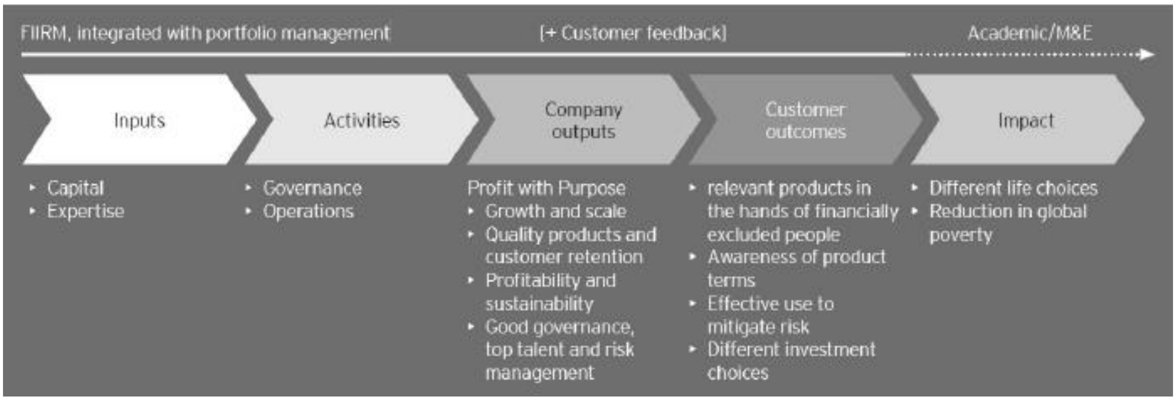

Figure 7: Impact Value Chain model of Leapfrog Investment (J.P. Morgan 2015).

It is necessary to cover the main operational activities with insight into what the impact goals the bank and its investees want to achieve. Bank needs to discuss with their borrowers about the output and outcome expectations and uses this information to keep the projects to go according to plan. The parties also need to reach an agreement on how much control the investees can exert on the results of outputs and outcomes. Additionally, the bank has to determine the limit of the outcomes, and to what extent they can claim them as the consequences of its outputs.

Step 2: Select metrics

The next step is to choose what to measure and how to measure it. It is a crucial process to determine whether a project meets the goals laid out in the earlier stage. Metrics are the specific indicators used in the impact measurement system to evaluate the outputs and outcomes of projects and translate them into value terms so that banks and its borrowers can have a better understanding of the level of impact generated from the investments. Typical indicators include: measurement of output volumes, measurements of change in people's lives and behaviour, reports on progress of beneficiaries, results of feedback questionnaires or survey etc.

The bank can either use available standardized core metrics or individualized metrics developed in-house or a combination of both. There are metrics that can be applied across sectors and regions such as the popular Social Return On Investment (SROI) and B Impact Assessment (BIA) methods. These metrics, while helpful and valuable, offer a generic and broad picture of the impact, which explains why ethical banks often add sector-specific metrics used as complemental measures to achieve results. For example, as mentioned in previous chapter, Triodos Bank uses the conversion rates set by Greenhouse Gas Protocol Initiative and the Ecological Footprint method to derive the impact values of its environmental projects. Another approach in selecting metrics is taking the lead from the investees and inquiring them about which specific metrics they use and how they collect data. After that, the bank can unify the measurement process with their own metrics, other complemental external indicators or create new metrics if needed. Overall, good metrics are ones that display these qualities:

- Have the bearing on the mission at hand
- Responsive to change (meaning that it produces the different results in different conditions)
- Specific to what is being measured
- Cover all dimensions of the impact (e.g. scale, quality etc.)
- Consistent and reliable (so that they can be used for comparison with past performances or with other projects)
- Easy to be integrated across financial and impact goals
- Allow for goal setting

- Simple to implement

IRIS is the product of the Global Impact Investing Network (GIIN), a non-profit organization dedicated to increasing effectiveness of impact investing. IRIS houses a catalogue of thematic metrics sets used to measure the social, environmental, and financial performances of the investments of various sectors. Ethical banks can design their own metrics framework based on the pool of selections listed below: (IRIS 2016.)

- B Impact Assessment (and GIIRS Rating) Aligned Metrics
- Community Banking Metrics
- GRI G4 Sustainability Reporting Guidelines
- Harmonized Indicators for Private Sector Operations
- Health Metrics
- Impact Employment Metrics
- Land Conservation Metrics
- Metrics for Investments in Early-Stage Enterprises
- Microenterprise Metrics
- Microinsurance Metrics
- Off-grid Energy Metrics
- Small and Growing Business Metrics
- Social Performance Metrics for Microfinance
- Sustainable Agriculture Metrics

Step 3: Set targets and objectives

After choosing the metrics, the bank and its investees need to determine the targets and objectives of the projects. Target is often related to a numerical value, while objective can be a broader notion. For example, with 1 million EUR loan, the target is to create enough office space for 100 people and the objective is to provide workers with a better working environment. Target does not need to be a specific number; it can be within a range or is assessed against a certain benchmark. Setting targets and objectives for key performance metrics encourages investees to drive towards set goals and helps the bank to understand the contexts of the performance of the investments.

6.2 Suggestion for future research

There has not been much research on the subjects handled by this thesis. Therefore, the authors believe that a future researcher finds plenty opportunities to deepen and extend the available knowledge. The authors suggest to research about how shareholders and other stakeholders can participate in the process of monitoring as well as measuring impacts. Investors and shareholders have an interest which is very comparable to the one of the ethical bank. Hence, the authors expect that a cooperation with them will only benefit both parties.

Another suggestion is the difference in the approaches banks of different countries will choose. This research focussed on banks of three different countries, which are all located within the European Union. A research topic could be to explore the processes of other ethical banks spread around the world. This would vastly increase the knowledge pool for a new bank and aid in learning from progression others banks have.

6.3 Assessment of own learning

This thesis was helpful in various regards. The authors learned a lot about what amount of detail and inside knowledge the seemingly small field of monitoring and impact measurement for ethical banks requires. There is a lot of detailed planning and process evaluation necessary in order to avoid failures in this field. Failures would result in wasting a lot of resources (including time & money) – resources which an ethical bank normally does not have. Therefore, an approach based on trial-and-error would not be beneficial as it exposes the bank to the risk of losing credibility and, ultimately, bankruptcy. This is of great learning for the authors as it does not only apply to ethical banks but the majority of small and medium sized enterprises, and especially start-ups. These are likely futures employers for the authors and therefore, are of special importance to them.

On another note, the authors learned that it requires quite a lot of dedication to finish a thesis study as a pair. There is a lot of coordination and focus necessary to ensure the integrity of the study. The authors had trouble understanding this in time. However, with some delay they managed to focus on the same goal again and finish the necessary research. Both sides learned a great deal out of this work which is likely to raise benefits in future careers.

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Attachments

Attachment 1. Interview outline and sample questions

Theme 1: Loan Criteria

1. When negotiating with projects over loans, do you set fixed (ethical) criteria they have to fulfil? Besides the more general ones mentioned on the website
    a. *Triodos: How does it work if a project spans 2 or more of your categories?*

Theme 2: Monitoring Processes

2. Do you have any method to monitor the projects you financed?
3. How does this method work?
    a. How much time do you spend on monitoring?
    b. How many people are usually assigned to oversight one project?
    c. Is there a separate team responsible for monitoring tasks?
    d. How close are you to the project during its runtime?
4. Do you work together with the shareholders/owners of a financed company/project (as they have an interest in the success of their project, too)

Theme 3: Impact Measurement

5. Do you measure the outcome / impact / end result of the projects?
6. How do you measure the outcome / impact / end result of the projects?
7. Why do you measure the outcome / impact / end result of the projects?
8. Are there any projects which do not meet the expectations set when agreeing on a loan or other forms of financing?
9. In general, how many projects are not successful?
10. Are there any sectors which have more or less problems than others?
11. What are common reasons for a project to not meet the expectations?
12. Did it ever happen that someone did not fulfil the ethical criteria on purpose or did not care about complying to them at all?
13. What do you do when a project does not meet the set criteria?
    a. Internally – Will you reflect your criteria or your financing processes? Will you change your approach?
    b. Externally – Do you help the company/project to improve?